

Lazard Ltd  
Form 10-Q  
November 07, 2006  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2006

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

001-32492

(Commission File Number)

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**LAZARD LTD**

(Exact name of registrant as specified in its charter)

Bermuda  
(State or Other Jurisdiction of Incorporation  
or Organization)

98-0437848  
(I.R.S. Employer Identification No.)

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Clarendon House

2 Church Street

Hamilton HM11, Bermuda

(Address of principal executive offices)

Registrant's telephone number: (441) 295-1422

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of October 31, 2006, there were 37,503,668 shares of the registrant's Class A common stock and one share of the registrant's Class B common stock outstanding.

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*When we use the terms "Lazard", "we", "us", "our", and "the Company", we mean Lazard Ltd, a company incorporated under the laws of Bermuda, and its subsidiaries, including Lazard Group LLC, a Delaware limited liability company ("Lazard Group"), that is the current holding company for our businesses. Lazard Ltd has no material assets other than indirect ownership as of September 30, 2006 of approximately 37.7% of the common membership interests in Lazard Group and its controlling interest in Lazard Group.*

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\* These unaudited condensed consolidated financial statements reflect the historical results of operations and financial position of Lazard Ltd, including consolidation of its investment in Lazard Group LLC, formerly known as Lazard LLC and referred to herein as Lazard Group, for all periods presented. Prior to May 10, 2005, the date of Lazard Ltd's equity public offering (as described in Note 1 of the accompanying Notes to Unaudited Condensed Consolidated Financial Statements), the unaudited condensed consolidated financial statements included herein represent the financial statements of Lazard Group. The results of operations and financial condition for certain businesses that Lazard Group no longer owns are reported as discontinued operations. The historical unaudited condensed consolidated financial statements for the three month and nine month periods ended September 30, 2005 do not reflect what the results of operations of Lazard Ltd or Lazard Group would have been had these companies been stand-alone, public companies for such periods. In addition, the results of operations for periods prior to May 10, 2005 are not comparable to results of operations for subsequent periods. Specifically, prior to May 10, 2005, the historical results of operations of Lazard Group do not give effect to the following matters:

Payment for services rendered by Lazard Group's managing directors, which, as a result of Lazard Group operating as a limited liability company, historically has been accounted for as distributions from members' capital, or in some cases as minority interest, rather than as compensation and benefits expense. As a result, prior to May 10, 2005, Lazard Group's operating income included within the accompanying unaudited condensed consolidated financial statements did not reflect payments for services rendered by its managing directors. For periods subsequent to the consummation of the equity public offering and financing transactions, the Company now includes all payments for services rendered by its managing directors and distributions to holders of profit participation interests in Lazard Group (profit participation members) in compensation and benefits expense.

U.S. corporate federal income taxes, since Lazard Group has operated in the U.S. as a limited liability company that was treated as a partnership for U.S. federal income tax purposes. As a result, Lazard Group's income had not been subject to U.S. federal income taxes. Taxes related to income earned by partnerships represent obligations of the individual partners. Outside the U.S., Lazard Group historically had operated principally through subsidiary corporations and had been subject to local income taxes. Prior to May 10, 2005, income taxes reflected within Lazard Group's results of operations included within the accompanying unaudited condensed consolidated financial statements are attributable to taxes incurred in non-U.S. entities and to New York City Unincorporated Business Tax (UBT) attributable to Lazard Group's operations apportioned to New York City. Subsequent to the equity public offering, the unaudited condensed consolidated financial statements of Lazard Ltd include U.S. corporate federal income taxes on its allocable share of the results of operations of Lazard Group, giving effect to the post equity public offering structure.

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Minority interest in net income relating to LAZ-MD Holdings' ownership interest of Lazard Group's common membership interests since May 10, 2005. Prior to May 10, 2005, Lazard Ltd had no ownership interest in Lazard Group and all net income was allocable to the then members of Lazard Group. Commencing May 10, 2005, minority interest in net income includes LAZ-MD Holdings' ownership interest of Lazard Group's common membership interests.

The use of proceeds from the financing transactions.

The net incremental interest expense related to the financing transactions.

**Table of Contents****LAZARD LTD****CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION****SEPTEMBER 30, 2006 AND DECEMBER 31, 2005****(UNAUDITED)****(dollars in thousands, except for per share data)**

	September 30, 2006	December 31, 2005
<b>ASSETS</b>		
Cash and cash equivalents	\$ 530,292	\$ 492,309
Cash and securities segregated for regulatory purposes	29,334	20,596
Securities purchased under agreements to resell	10,001	23,358
Securities owned at fair value:		
Bonds Corporate	368,448	228,927
Non-U.S. Government and agency securities	18,900	40,285
Equities	3,004	2,964
	390,352	272,176
Swaps and other contractual agreements	111	186
Receivables net:		
Banks	331,205	347,912
Fees	275,759	280,923
Customers	66,844	65,253
Related parties	16,993	53,932
	690,801	748,020
Long-term investments	84,776	80,843
Other investments	4,758	4,473
Property (net of accumulated amortization and depreciation of \$174,414 and \$156,935 at September 30, 2006 and December 31, 2005, respectively)	161,525	156,630
Goodwill	16,580	15,996
Other assets	112,731	96,310
Total assets	\$ 2,031,261	\$ 1,910,897

See notes to unaudited condensed consolidated financial statements.

**Table of Contents****LAZARD LTD****CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION (Continued)****SEPTEMBER 30, 2006 AND DECEMBER 31, 2005****(UNAUDITED)****(dollars in thousands, except for per share data)**

	September 30, 2006	December 31, 2005
<b>LIABILITIES, MINORITY INTEREST AND STOCKHOLDERS DEFICIENCY</b>		
Liabilities:		
Securities sold under agreements to repurchase	\$ 6,584	\$ 31,853
Deposits and other customer payables	676,870	521,433
Related party payables	3,430	3,919
Accrued compensation and benefits	282,747	346,090
Swaps and other contractual agreements	718	3,028
Senior borrowings	1,083,512	1,022,082
Capital lease obligations	24,690	23,844
Other liabilities	422,651	517,590
Subordinated borrowings	200,000	200,000
Total liabilities	2,701,202	2,669,839
Commitments and contingencies		
Minority interest	43,361	111,729
<b>STOCKHOLDERS DEFICIENCY</b>		
Common stock:		
Class A, par value \$.01 per share (500,000,000 shares authorized; 37,503,668 and 37,500,000 shares issued and outstanding at September 30, 2006 and December 31, 2005, respectively)	375	375
Class B, par value \$.01 per share (1 share authorized; 1 share issued and outstanding)		
Additional paid-in-capital	(795,966)	(885,690)
Accumulated other comprehensive income (loss), net of tax	(8,066)	(34,342)
Retained earnings	94,534	48,986
	(709,123)	(870,671)
Less: Class A common stock held in treasury, at cost (115,000 shares at September 30, 2006)	(4,179)	
Total stockholders' deficiency	(713,302)	(870,671)
Total liabilities, minority interest and stockholders' deficiency	\$ 2,031,261	\$ 1,910,897

See notes to unaudited condensed consolidated financial statements.

**Table of Contents****LAZARD LTD****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****FOR THE THREE MONTH AND NINE MONTH PERIODS ENDED SEPTEMBER 30, 2006 AND 2005****(UNAUDITED)****(dollars in thousands, except for per share data)**

	Three Months Ended		Nine Months Ended	
	September 30, 2006	September 30, 2005	September 30, 2006	September 30, 2005
<b>REVENUE</b>				
Investment banking and other advisory fees	\$ 183,318	\$ 251,663	\$ 655,704	\$ 615,361
Money management fees	116,113	101,282	346,584	302,507
Commissions	3,195	3,569	12,474	11,354
Underwriting	2,487	4,626	12,912	10,155
Investment gains and losses net	4,448	4,944	13,673	8,446
Interest income	11,755	10,210	29,593	24,260
Other	2,706	5,207	26,631	15,823
Total revenue	324,022	381,501	1,097,571	987,906
Interest expense	26,510	24,598	76,893	53,541
Net revenue	297,512	356,903	1,020,678	934,365
<b>OPERATING EXPENSES</b>				
Compensation and benefits (and, commencing May 10, 2005, distributions to profit participation members)(*)	180,982	215,199	615,269	482,228
Premises and occupancy costs	16,820	16,653	50,956	50,513
Professional fees	20,226	12,516	55,630	36,111
Travel and entertainment	10,643	10,663	30,595	30,768
Communications and information services	6,853	7,424	21,282	22,316
Equipment costs	4,973	5,975	15,213	15,543
Other	7,822	11,184	19,731	31,608
Total operating expenses	248,319	279,614	808,676	669,087
<b>OPERATING INCOME FROM CONTINUING OPERATIONS(*)</b>	<b>49,193</b>	<b>77,289</b>	<b>212,002</b>	<b>265,278</b>
Provision for income taxes(*)	10,153	17,177	44,827	50,443
<b>INCOME FROM CONTINUING OPERATIONS BEFORE MINORITY INTEREST IN NET INCOME(*)</b>	<b>39,040</b>	<b>60,112</b>	<b>167,175</b>	<b>214,835</b>
Minority interest in net income	25,882	41,101	110,786	77,707
<b>INCOME FROM CONTINUING OPERATIONS(*)</b>	<b>13,158</b>	<b>19,011</b>	<b>56,389</b>	<b>137,128</b>
<b>LOSS FROM DISCONTINUED OPERATIONS(*) (net of income tax provision of \$253 and \$3,330 for the three month and nine month periods ended September 30, 2005, respectively)</b>		(408)		(17,576)
<b>NET INCOME (NET INCOME ALLOCABLE TO MEMBERS OF LAZARD GROUP FOR PERIODS PRIOR TO MAY 10, 2005)(*)</b>	<b>\$ 13,158</b>	<b>\$ 18,603</b>	<b>\$ 56,389</b>	<b>\$ 119,552</b>



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### WEIGHTED AVERAGE SHARES OF CLASS A COMMON STOCK

#### OUTSTANDING(\*\*):

Basic	37,388,185	37,500,000	37,457,275	37,500,000
Diluted	41,577,615	37,528,978	41,747,068	37,518,513

#### NET INCOME PER SHARE OF CLASS A COMMON STOCK BASIC:

Income from continuing operations(**)	\$0.35	\$0.51	\$1.51	\$0.81
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#### NET INCOME PER SHARE OF CLASS A COMMON STOCK DILUTED:

Income from continuing operations(**)	\$0.34	\$0.51	\$1.45	\$0.81
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#### DIVIDENDS PAID PER SHARE OF CLASS A COMMON STOCK(\*\*)

\$0.09	\$0.052	\$0.27	\$0.052
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(\*) Excludes, as applicable, with respect to periods ended prior to May 10, 2005 (a) payments for services rendered by Lazard Group's managing directors, which, as a result of Lazard Group operating as a limited liability company, historically had been accounted for as distributions from members' capital, or in some cases as minority interest, rather than as compensation and benefits expense, and (b) U.S. corporate federal income taxes, since Lazard Group has operated in the U.S. as a limited liability company that was treated as a partnership for U.S. federal income tax purposes.

(\*\*) Applicable with respect to periods subsequent to May 10, 2005, the date of our equity public offering.

See notes to unaudited condensed consolidated financial statements.

**Table of Contents****LAZARD LTD****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****FOR THE NINE MONTH PERIODS ENDED SEPTEMBER 30, 2006 AND 2005****(UNAUDITED)****(dollars in thousands)**

	<b>Nine Months Ended September 30,</b>	<b>2006</b>	<b>2005</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income (net income allocable to members of Lazard Group prior to May 10, 2005)	\$	56,389	\$ 119,552
Adjustments to reconcile net income to net cash provided by operating activities:			
Noncash charges included in net income:			
Depreciation and amortization of property		10,684	11,339
Amortization of deferred expenses, stock units and interest rate hedge		18,168	1,064
Gain on termination of strategic alliance in Italy		(13,695)	
Minority interest in net income		110,786	77,707
(Increase) decrease in operating assets:			
Cash and securities segregated for regulatory purposes		(7,088)	(10,498)
Securities purchased under agreements to resell		14,797	(5,058)
Securities owned, at fair value and swaps and other contractual agreements		(96,455)	52,773
Receivables		90,965	(80,195)
Marketable, long-term and other investments		682	168,793
Other assets		(14,031)	3,200
Assets of discontinued operations			1,485,363
Increase (decrease) in operating liabilities:			
Securities sold under agreements to repurchase		(27,107)	(28,600)
Swaps and other contractual agreements		(2,486)	427
Deposits and other payables		117,324	106,526
Accrued compensation and other liabilities		(111,572)	78,714
Liabilities of discontinued operations			(1,223,257)
<b>Net cash provided by operating activities</b>		<b>147,361</b>	<b>757,850</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Additions to property		(5,253)	(3,284)
Disposals and retirements of property		602	9,761
<b>Net cash provided by (used in) investing activities</b>		<b>(4,651)</b>	<b>6,477</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Proceeds from issuance of Class A common stock, net of expenses of \$65,844			871,656
Proceeds from issuance of Class B common stock			1
Proceeds from issuance of equity security units, net of expenses of \$15,941			421,559
Distribution to members and capital withdrawals			(417,900)
Lazard Group LLC repurchase of common membership interest from LAZ-MD Holdings			(4,507)
Purchase contracts relating to equity security units			(6,013)
Settlement of interest rate hedge			(11,003)
Redemption of historical partner interests (including mandatorily redeemable preferred stock of \$100,000)			(1,617,032)
Distribution of separated business			(243,178)
Distributions to LAZ-MD Holdings and LFCM Holdings			(150,000)
Indemnity from LFCM Holdings relating to U.K. pension			53,600
Proceeds from issuance of Lazard Group senior notes, net of original issue discount and other expenses of \$4,417			545,583
Proceeds from other senior borrowings			17,509

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Repayment of senior borrowings, including make-whole payment of \$7,650 in 2005	(34,570)	(74,239)
Repayment of capital lease obligations	(882)	(21,960)
Distributions relating to minority interest, including, in 2006 and 2005, \$38,036 and \$3,230 to LAZ-MD Holdings	(60,140)	(55,698)
Class A common stock dividends	(10,115)	(1,950)
Additional costs relating to issuance of Class A common stock	(2,677)	
Purchase of Class A common stock	(4,179)	
Net cash used in financing activities	(112,563)	(693,572)
<b>EFFECT OF EXCHANGE RATE CHANGES ON CASH</b>	<b>7,836</b>	<b>(4,525)</b>
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>37,983</b>	<b>66,230</b>
<b>CASH AND CASH EQUIVALENTS January 1</b>	<b>492,309</b>	<b>305,753</b>
<b>CASH AND CASH EQUIVALENTS September 30</b>	<b>\$ 530,292</b>	<b>\$ 371,983</b>
<b>Supplemental financing non-cash transaction:</b>		
Issuance of senior promissory note for the acquisition of equity interest in Lazard Italy	\$ 96,000	

See notes to unaudited condensed consolidated financial statements.

**Table of Contents****LAZARD LTD****CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS DEFICIENCY****FOR THE NINE MONTH PERIOD ENDED SEPTEMBER 30, 2006****(UNAUDITED)****(dollars in thousands)**

	Common Stock		Additional Paid-in- Capital	Accumulated Other Comprehensive Income (Loss), Net of Tax	Retained Earnings	Class A Common Stock Held In Treasury	Total Stockholders Deficiency
	Shares	\$					
Balance January 1, 2006	37,500,001	\$ 375	\$ (885,690)	\$ (34,342)	\$ 48,986	\$	\$ (870,671)
Comprehensive income:							
Net income available for Class A common stockholders					56,389		56,389
Other comprehensive income net of tax:							
Currency translation adjustment				24,872			24,872
Minimum pension liability adjustment				579			579
Amortization of interest rate hedge				825			825
Comprehensive income							82,665
Class A common stock dividends							
Amortization and issuance of stock units			16,064		(10,115)		(10,115)
Conversion of DSUs to Class A common stock	3,668						16,064
RSU dividend-equivalents			726		(726)		
Purchase of 115,000 shares of Class A common stock						(4,179)	(4,179)
Other capital activities, including additional costs relating to issuance of Class A common stock			3,328				3,328
Adjustment to reclassify minority interest share of undistributed net income to additional paid-in-capital			69,606				69,606
Balance September 30, 2006	37,503,669(*)	\$ 375	\$ (795,966)	\$ (8,066)	\$ 94,534	\$ (4,179)	\$ (713,302)

(\*) Includes 37,503,668 shares of the Company's Class A common stock and 1 share of the Company's Class B common stock  
See notes to unaudited condensed consolidated financial statements.

**Table of Contents****LAZARD LTD****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(dollars in thousands, except for per share data, unless otherwise noted)

**1. ORGANIZATION AND BASIS OF PRESENTATION****Organization**

The accompanying unaudited condensed consolidated financial statements of Lazard Ltd and subsidiaries (collectively referred to as "Lazard Ltd" or the "Company") including, subsequent to May 10, 2005, Lazard Ltd's investment in Lazard Group LLC (a Delaware limited liability company, collectively referred to, with its subsidiaries, as "Lazard Group") have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America ("U.S. GAAP") for complete financial statements and should be read in conjunction with the audited consolidated financial statements and notes thereto included in Lazard Ltd's annual report on Form 10-K for the year ended December 31, 2005 (the "Form 10-K"). The December 31, 2005 unaudited condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by U.S. GAAP. The accompanying unaudited condensed consolidated financial statements reflect all adjustments, which are, in the opinion of management, necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods presented. Preparing financial statements requires management to make estimates and assumptions that affect the amounts that are reported in the financial statements and the accompanying disclosures. Although these estimates are based on management's best knowledge of current events and actions that Lazard may undertake in the future, actual results may differ materially from the estimates. The consolidated results of operations for the three month and nine month periods ended September 30, 2006 are not necessarily indicative of the results to be expected for any future period or the full fiscal year. Certain prior year amounts have been reclassified to conform to the manner of presentation in the current year.

Lazard Ltd is a Bermuda holding company that was incorporated in October 2004. Pursuant to a Registration Statement on Form S-1 (File No. 333-121407) declared effective by the SEC on May 4, 2005 (the "Registration Statement") for the initial public offering of shares of Lazard Ltd's Class A common stock, par value \$0.01 per share ("Class A common stock"), Lazard Ltd issued on May 10, 2005, at \$25 per share, 34,183,162 shares of its Class A common stock in a registered initial public offering (the "equity public offering"). In addition, on May 10, 2005, pursuant to the IXIS Placements (see Note 2 of Notes to Unaudited Condensed Consolidated Financial Statements) and the cashless exchange of certain of our chief executive officer's interests in Lazard Group with Lazard Ltd, the Company issued 2,000,000 shares of its Class A common stock and 1,316,838 shares of its Class A common stock, respectively. These issuances, together with the 34,183,162 shares of Class A common stock issued pursuant to the equity public offering, resulted in the Company having 37,500,000 shares of its Class A common stock outstanding at the time of the equity public offering. The Company, through a number of newly-formed, wholly-owned subsidiaries, contributed the net proceeds from the equity public offering, along with the net proceeds it received from the financing transactions (as described in Note 2 of Notes to Unaudited Condensed Consolidated Financial Statements), to Lazard Group in exchange for 37,500,000 Lazard Group common membership interests, representing 37.5% of Lazard Group's total common membership interests as of May 10, 2005, and, after giving effect to (i) the repurchase and forfeiture of a portion of the Lazard Group common membership interests held by LAZ-MD Holdings LLC ("LAZ-MD Holdings"), as well as (ii) certain other share issuances by Lazard Ltd subsequent to December 31, 2005, approximately 37.7% and 37.6% of all outstanding Lazard Group common membership interests as of September 30, 2006 and December 31, 2005, respectively. The Company, through its control of the managing members of Lazard Group, controls Lazard Group.

Lazard Group is governed by an Operating Agreement dated as of May 10, 2005, as amended (the "Operating Agreement").

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**LAZARD LTD**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(dollars in thousands, except for per share data, unless otherwise noted)**

The Company's sole operating asset is its ownership of the common membership interest of Lazard Group and its managing member interest of Lazard Group, whose current principal activities are divided into two business segments:

Financial Advisory, which includes providing advice on mergers and acquisitions, restructurings, capital raising and similar transactions, and

Asset Management, which includes the management of equity and fixed income securities and merchant banking funds. In addition, Lazard Group records selected other activities in Corporate, including cash and marketable investments, certain long-term investments, and the commercial banking activities of Lazard Group's Paris-based Lazard Frères Banque SA ( LFB ). LFB is a registered bank regulated by the Banque de France. LFB's primary commercial banking operations include the management of the treasury positions of Lazard Group's Paris House through its money market desk and, to a lesser extent, credit activities relating to securing loans granted to clients of Lazard Frères Gestion SAS ( LFG ) and custodial oversight over assets of various clients. In addition, LFB operates many support functions of the Paris House. Lazard Group also allocates outstanding indebtedness to Corporate.

Prior to May 10, 2005, Lazard Group also had a business segment called Capital Markets and Other, which consisted of equity, fixed income and convertibles sales and trading, broking, research and underwriting services and merchant banking fund management activities outside of France as well as other specified non-operating assets and liabilities. This business segment's assets and liabilities (referred to below as the separated businesses ) were separated from Lazard Group on May 10, 2005, and the operating results of this former segment are reflected as discontinued operations for all periods prior to May 10, 2005. We refer to the transfer of the separated business as the separation.

The unaudited condensed consolidated financial statements include Lazard Ltd, Lazard Group and Lazard Group's principal operating subsidiaries: Lazard Frères & Co. LLC ( LFNYS ), a New York limited liability company, along with its subsidiaries, including Lazard Asset Management LLC and its subsidiaries (collectively referred to as LAM ); Lazard Frères SAS and Maison Lazard SAS, French limited liability companies, along with their respective subsidiaries, including LFB and LFG (collectively referred to as LFP ); and Lazard & Co., Limited ( LCL ), through Lazard & Co., Holdings Limited, an English private limited company ( LCH ); together with their jointly-owned affiliates and subsidiaries.

**The Separation and Recapitalization Transactions**

On May 10, 2005, Lazard completed the separation and recapitalization transactions, including the financing transactions described in Note 2 of Notes to Unaudited Condensed Consolidated Financial Statements.

***The Separation***

In the separation, Lazard Group transferred the separated businesses to LFCM Holdings LLC ( LFCM Holdings ) through several steps. First, LAZ-MD Holdings was formed as the new holding company for Lazard Group. Pursuant to this formation, all of the persons who were members of Lazard Group prior to the formation became members of LAZ-MD Holdings and ceased to hold any membership interests in Lazard Group. Lazard Group then contributed the separated businesses to LFCM Holdings, which was then a subsidiary of Lazard Group, and distributed all of the LFCM Holdings interests to LAZ-MD Holdings. After the redemption of the

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**LAZARD LTD**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(dollars in thousands, except for per share data, unless otherwise noted)**

historical partners described below, LAZ-MD Holdings distributed all of the LFCM Holdings interests to its members. Accordingly, after the separation, LFCM Holdings was wholly-owned by the members of LAZ-MD Holdings, including Lazard Group's managing directors at the time of the separation.

In the separation, Lazard Group retained all of the Company's Financial Advisory and Asset Management businesses. In addition, under the business alliance agreement, dated as of May 10, 2005, between Lazard Group and LFCM Holdings (the "business alliance agreement"), Lazard Group was granted the option to acquire the North American and European merchant banking businesses of LFCM Holdings.

***The Recapitalization***

On the same day as the separation, LAZ-MD Holdings and Lazard Group effected a recapitalization of their companies. The recapitalization had three principal parts: the financing transactions, the redemption of the historical partners' interests and mandatorily redeemable preferred interests of Lazard Group and the issuance of LAZ-MD Holdings exchangeable interests to working members. "Historical partners" refers to certain former members of Lazard Group that existed prior to the recapitalization, which consisted of Eurazeo S.A., descendants and relations of Lazard Group's founders, several historical partners of Lazard Group's predecessor entities, several current and former managing directors and the other members of these classes. "Working members" refers to members of Lazard Group that existed prior to the recapitalization, which consisted of current and former managing directors of Lazard Group and the separated businesses.

***The Financing Transactions***

On May 10, 2005, the Company completed the financing transactions, which consisted of:

the equity public offering,

the initial offering of equity security units (the "ESU offering"),

the private offering of Lazard Group senior notes, and

the private placement of securities to IXIS Corporate & Investment Bank ("IXIS").

For a further description of the financing transactions, see Note 2 of Notes to Unaudited Condensed Consolidated Financial Statements.

The Company used the net proceeds from the financing transactions primarily to:

redeem Lazard Group membership interests, including Lazard Group's mandatorily redeemable preferred stock, held by the historical partners for \$1,617,032 (including the value of our chief executive officer's historical interests (\$32,921), which were exchanged for shares of Lazard Ltd Class A common stock in lieu of cash, and the exchange of certain of these membership interests for specific Lazard Group long-term investments valued at \$39,774),

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capitalize LFCM Holdings and LAZ-MD Holdings in the amount of \$67,000 and \$83,000, respectively,

repay the 7.53% senior notes due 2011 in aggregate principal amount of \$50,000 as well as a related make-whole payment of \$7,650, and

pay transaction fees and expenses.



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**LAZARD LTD**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(dollars in thousands, except for per share data, unless otherwise noted)**

***The Redemption of the Historical Partners' Interests***

As noted above, a primary purpose of the financing transactions was the redemption of the historical partners' interests. Prior to the separation and recapitalization, Lazard Group had three general classes of membership interests:

the working member interests, which were owned by working members and consisted of capital and the right to participate in profit and the goodwill of Lazard Group if a fundamental transaction occurred,

the historical partner interests, which were owned by the historical partners and consisted of capital and the right to participate in profit and the goodwill of Lazard Group if a fundamental transaction occurred, and

the mandatorily redeemable preferred interests, which were owned by certain of the historical partners and consisted of the right to a preferred dividend of 8% per annum and a fixed liquidation amount.

As part of the recapitalization transactions, historical partner interests and preferred interests generally were redeemed for cash.

***Exchange of Working Member Interests for LAZ-MD Holdings Interests***

In connection with the formation of LAZ-MD Holdings, the working member interests were exchanged with LAZ-MD Holdings for limited liability company interests in LAZ-MD Holdings. Each holder of a working member interest at the time of the separation and recapitalization transactions received, in exchange for his or her working member interest, a redeemable capital interest in LAZ-MD Holdings consisting of an equivalent amount of capital of LAZ-MD Holdings, an exchangeable interest in LAZ-MD Holdings and, if applicable, a right to receive distributions from LAZ-MD Holdings. The former holders of working member interests hold all of the limited liability company interests in LAZ-MD Holdings.

The separation and recapitalization transactions were consummated pursuant to the master separation agreement, dated as of May 10, 2005, by and among Lazard Ltd, Lazard Group, LAZ-MD Holdings and LFCM Holdings (the master separation agreement).

***Basis of Presentation***

The consolidated financial statements are prepared in conformity with U.S. GAAP. The Company's policy is to consolidate all majority-owned subsidiaries in which it has a controlling financial interest as well as variable interest entities (VIEs) where the Company is deemed to be the primary beneficiary. All material intercompany transactions and balances have been eliminated.

In accordance with Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 46 (R), *Consolidation of Variable Interest Entities* (FIN 46 R), the Company also consolidates any VIEs for which it is the primary beneficiary. In connection with the separation, Lazard Group transferred its general partnership interests in various VIEs to a subsidiary of LFCM Holdings. Lazard Group has determined that it is no longer the primary beneficiary with respect to those VIEs and, as a result, the Company no longer consolidates such VIEs. Amounts related to consolidation of such VIEs, for the three month and nine month periods ended September 30, 2005 are included in loss from discontinued operations on the unaudited condensed consolidated statements of income.

The Company prepared an assessment that considered quantitative factors and qualitative factors that included, but was not limited to, the structure and purpose of the separation and recapitalization transactions, corporate governance and the controlling parties of Lazard Group, and

management concluded that Lazard Ltd is the entity that

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**LAZARD LTD**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(dollars in thousands, except for per share data, unless otherwise noted)**

is most closely associated with Lazard Group and therefore should consolidate the operations of Lazard Group. Accordingly, the accompanying unaudited condensed consolidated statements of financial condition as of September 30, 2006 and December 31, 2005 reflect the consolidated statements of financial condition of Lazard Ltd. The unaudited condensed consolidated statements of income for the three month and nine month periods ended September 30, 2006 and the three month period ended September 30, 2005 and the unaudited condensed consolidated statement of cash flows for the nine month period ended September 30, 2006 reflect the consolidated operating results and cash flows of Lazard Ltd and its subsidiaries. The unaudited condensed consolidated statement of income and the unaudited condensed consolidated statement of cash flows for the nine month period ended September 30, 2005 relate to Lazard Group and its subsidiaries for the period prior to May 10, 2005, and, from May 10, 2005 through September 30, 2005, reflect the consolidated operating results of Lazard Ltd and its subsidiaries.

The accompanying unaudited condensed consolidated statement of income and the unaudited condensed consolidated statement of cash flows for the nine month period ended September 30, 2005 do not reflect what the results of operations and cash flows of the Company would have been had it been a stand-alone, public company prior to May 10, 2005. In addition, the results of operations for periods until the equity public offering on May 10, 2005 are not comparable to results of operations for subsequent periods as described below.

Payments for services rendered by the Company's managing directors, which, as a result of Lazard Group operating as a limited liability company, historically had been accounted for as distributions from members' capital, or in some cases as minority interest, rather than as compensation and benefits expense, and distributions to profit participation members. As a result, prior to May 10, 2005, Lazard Group's operating income included within the accompanying unaudited condensed consolidated financial statements did not reflect payments for services rendered by its managing directors. For periods subsequent to the consummation of the equity public offering and the financing transactions as described in Note 2 of Notes to Unaudited Condensed Consolidated Financial Statements, the Company now includes all payments for services rendered by its managing directors and distributions to profit participation members in compensation and benefits expense.

Payments for services rendered by managing directors of LAM (and employee members of LAM) had, prior to May 10, 2005, been accounted for as minority interest in net income and since that date such payments, together with distributions to profit participation members, have been included within compensation and benefits expense.

The Company's income has not been subject to U.S. corporate federal income taxes, because Lazard Group operated in the U.S. as a limited liability company that was treated as a partnership for U.S. federal income tax purposes. As a result, Lazard Group's income had not been subject to U.S. corporate federal income taxes. Taxes related to income earned by partnerships represent obligations of the individual partners. Outside the U.S., Lazard Group historically had operated principally through subsidiary corporations and had been subject to local income taxes. Prior to May 10, 2005, income taxes reflected within Lazard Group's results of operations are attributable to taxes incurred in non-U.S. entities and to New York City Unincorporated Business Taxes (UBT) attributable to Lazard Group's operations apportioned to New York City. For periods subsequent to the equity public offering, the unaudited condensed consolidated financial statements of Lazard Ltd include U.S. corporate federal income taxes on its allocable share of the results of operations of Lazard Group, giving effect to the post equity public offering structure.

Commencing May 10, 2005, the unaudited condensed consolidated statements of income include a minority interest in net income relating to LAZ-MD Holdings' ownership interest of Lazard Group's common membership interests. Prior to May 10, 2005, there was no such minority interest, as Lazard



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**LAZARD LTD**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(dollars in thousands, except for per share data, unless otherwise noted)**

Ltd had no ownership interest in Lazard Group, and all net income was allocable to the then members of Lazard Group. As of September 30, 2006, LAZ-MD Holdings' ownership interest in Lazard Group was approximately 62.3%.

The use of proceeds from the financing transactions.

The net incremental interest expense related to the financing transactions.

In accordance with U.S. GAAP, the results of operations of the separated businesses have been segregated and are reported as discontinued operations in the unaudited condensed consolidated statements of income for the three month and nine month periods ended September 30, 2005. See Note 15 of Notes to Unaudited Condensed Consolidated Financial Statements for additional information relating to discontinued operations.

**2. EQUITY PUBLIC OFFERING AND OTHER FINANCING TRANSACTIONS**

**Equity Public Offering** As described above, on May 10, 2005, Lazard Ltd consummated its equity public offering. The aggregate gross proceeds relating to the offering amounted to \$854,579, and net proceeds to Lazard Ltd, after \$65,844 of estimated expenses incurred by Lazard Ltd in connection with the issuance and distribution of the Lazard Ltd Class A common stock (including underwriting discounts and commissions, expenses paid to the underwriters and certain other expenses), was \$788,735. Lazard Ltd contributed all the net proceeds from this offering to Lazard Group in exchange for a controlling interest in Lazard Group. In the nine month period ended September 30, 2006, additional costs of \$2,677 relating to issuance of Class A common stock were incurred, representing amounts in excess of estimated costs associated with the equity public offering. Such amount was recorded as a reduction to additional paid-in-capital.

**Other Financing Transactions** On May 10, 2005, the Company also completed the other financing transactions which are described below.

**ESU Offering** Concurrently with the equity public offering, the Company issued, for \$25 per unit, equity security units (the ESUs) for an aggregate offering amount of \$287,500 (and net proceeds of \$276,535) in the ESU offering. Each unit consists of (a) a contract which obligates holders to purchase, and the Company to sell, on May 15, 2008, a number of newly-issued shares of Class A common stock equal to a settlement rate based on the trading price of its Class A common stock during a period preceding that date and (b) a 1/40, or 2.5%, ownership interest in a 6.12% senior note due 2035 of an affiliate, Lazard Group Finance LLC, a Delaware limited liability company (Lazard Group Finance), with a principal amount of \$1 (the Lazard Group Finance Senior Notes). Prior to its merger with Lazard Group discussed below, Lazard Group Finance was a wholly-owned subsidiary of Lazard Group that was controlled by Lazard Ltd.

In connection with the quarterly contract adjustment payments on the purchase contracts, the Company recorded a liability as of May 10, 2005 for \$6,013 for the present value of such payments (including the similar contract adjustment payments related to IXIS as described below), with a corresponding charge to additional paid-in-capital. The liability will accrete over the three year period ending May 15, 2008, with a corresponding charge to interest expense.

The Company began making quarterly contract adjustment payments on the purchase contracts at an annual rate of 0.505% on August 15, 2005. The Company has the right to defer these quarterly contract adjustment payments. In general, during any period in which it defers such payments, the Company cannot declare or pay dividends on, make distributions with respect to, or redeem, purchase or acquire, or make a liquidation payment with respect to, any of its capital stock.

**Table of Contents****LAZARD LTD****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(dollars in thousands, except for per share data, unless otherwise noted)

The Lazard Group Finance Senior Notes, which bear interest at an annual rate of 6.12%, will mature (a) in the event of a successful remarketing, on any date no earlier than May 15, 2010 and no later than May 15, 2035, as we may elect, (b) in the event of a failed remarketing, on May 15, 2008 (the stock purchase date) and (c) otherwise on May 15, 2035. Lazard Group Finance used the proceeds from the ESU offering to purchase 6.12% senior notes from Lazard Group due 2035 (the Lazard Group Notes) with a principal amount of \$287,500. The Lazard Group Notes, which have substantially similar terms to the Lazard Group Finance Senior Notes, were pledged to secure the obligations of the Lazard Group Finance Senior Notes.

On December 19, 2005, Lazard Group consummated a Plan of Merger (the Merger Agreement) with Lazard Group Finance. The Merger Agreement provided for the merger of Lazard Group Finance with and into Lazard Group (the Merger). Pursuant to the Merger, Lazard Group Finance merged with and into Lazard Group, with Lazard Group continuing as the surviving company. In addition, Lazard Group Finance ceased to be the managing member of Lazard Group, and the co-managing members of Lazard Group Finance, which are two indirect wholly-owned subsidiaries of Lazard Ltd, became the co-managing members of Lazard Group. In connection with the Merger, Lazard Group became the successor registrant for Lazard Group Finance under the Securities Exchange Act of 1934, as amended.

Pursuant to the Merger and in accordance with the Indenture, dated as of May 10, 2005 (the Lazard Group Finance Indenture), Lazard Group assumed the obligations, including the remarketing, of Lazard Group Finance with respect to an aggregate principal amount of \$437,500 of Lazard Group Finance Senior Notes issued pursuant to the Lazard Group Finance Indenture (including an aggregate principal amount of \$150,000 related to IXIS as described below), which notes form a part of the 6.625% ESUs previously issued by Lazard Ltd. Simultaneously with the consummation of the Merger, in accordance with the terms of the Lazard Group Finance Indenture, all of the outstanding Lazard Group Finance Senior Notes were exchanged for, and replaced by, an aggregate principal amount of \$437,500 of Lazard Group Notes issued pursuant to the Indenture, dated as of May 10, 2005 (the Lazard Group Indenture), which Lazard Group Notes were previously held by Lazard Group Finance, and the Lazard Group Finance Indenture was discharged. In accordance with the terms of the Lazard Group Finance Indenture, after the completion of this exchange, the Lazard Group Notes replaced the Lazard Group Finance Senior Notes for all purposes under the ESUs, including by serving as collateral for the obligations of the holders of the ESUs in substitution for the Lazard Group Finance Senior Notes.

Prior to the issuance of the Class A common stock upon settlement of the purchase contracts, the ESUs will be reflected in Lazard Ltd's diluted net income per share using the treasury stock method. See Note 9 of Notes to Unaudited Condensed Consolidated Financial Statements for additional information regarding net income per share of Class A common stock.

**IXIS Placements** Under the IXIS placements, IXIS, which is a subsidiary of Caisse Nationale des Caisses d'Epargne, purchased an aggregate of \$200,000 of the Company's securities on May 10, 2005, \$150,000 of which were ESUs (the IXIS ESU placement) and \$50,000 of which were shares of Class A common stock. The terms of the ESUs issued in connection with the IXIS ESU placement are the same as the ESUs described above. The price per security paid by IXIS was equal, in the case of shares of Class A common stock, to the price per share in the equity public offering and, in the case of ESUs, the price per unit in the ESU offering. The Company contributed the net proceeds from the sale of Class A common stock to Lazard Group. Lazard Group Finance used the net proceeds from the IXIS ESU placement to purchase Lazard Group Notes with a principal amount of \$150,000.

**Lazard Group Senior Notes** Concurrent with the equity public offering, Lazard Group issued, in a private placement, \$550,000 aggregate principal amount of 7.125% senior notes due May 15, 2015 (the Lazard Group

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Senior Notes ). The Lazard Group Senior Notes were issued net of original issue discount of \$435. Interest on the notes is due May 15 and November 15 of each year, commencing on November 15, 2005. The notes are unsecured. A registration rights agreement, dated as of May 10, 2005, among Lazard Group and the initial purchasers of the Lazard Group senior notes provided the holders of the Lazard Group senior notes with registration rights. In that agreement Lazard Group agreed to register the offer and sale of substantially identical notes (the exchange notes ) in exchange for the privately-placed notes (the old notes ). In connection therewith, Lazard Group filed a registration statement on Form S-4 that was declared effective by the SEC on September 28, 2005 and Lazard Group commenced an exchange offer (the exchange offer ) on that date to exchange an aggregate principal amount of up to \$550,000 of the old notes for an equal aggregate principal amount of the exchange notes. The exchange offer expired on October 26, 2005. On October 31, 2005, Lazard Group closed the exchange offer, at which time it exchanged \$546,000 in aggregate principal amount of its old notes (approximately 99.3% of the aggregate principal amount of old notes outstanding) for \$546,000 in aggregate principal amount of its exchange notes. The exchange notes are substantially identical to the old notes, except that the exchange notes have been registered under the Securities Act of 1933, as amended; and, as a result, the transfer restrictions applicable to the old notes do not apply to the exchange notes.

The indenture governing the Lazard Group Senior Notes contains covenants that limit Lazard Group's ability and that of its subsidiaries, subject to important exceptions and qualifications, to, among other things, create a lien on any shares of capital stock of any designated subsidiary, and consolidate, merge or transfer all or substantially all of its assets and the assets of its subsidiaries. The indenture also contains a customary make-whole provision in the event of early redemption.

In connection with the issuance of the Lazard Group Senior Notes, on April 1, 2005, Lazard Group entered into an interest rate forward agreement with a bank for a notional amount of \$650,000. By entering into this interest rate forward agreement, Lazard Group was able to ensure that the base rate (excluding market-driven credit spreads) on the Lazard Group Senior Notes would be no greater than 4.5%. Lazard Group settled the interest rate forward agreement with the bank as of May 9, 2005, which required a payment by Lazard Group of \$13,004. Of this amount, in accordance with Statement of Financial Accounting Standards ( SFAS ) No. 133, *Accounting for Derivative Instruments and Hedging Activities* , as amended, \$11,003 was deemed to be the effective portion of the hedge and has been recorded within other comprehensive income (loss) and is being amortized as a charge to interest expense over the ten year term of the Lazard Group Senior Notes.

**Credit Facility** Concurrent with the equity public offering, Lazard Group entered into a five year, \$125,000 senior revolving credit facility (the Credit Facility ) with a group of lenders. On May 17, 2006, the Credit Facility was amended to provide for an increase in the aggregate commitments from \$125,000 to \$150,000. As of September 30, 2006 and December 31, 2005, \$0 and \$30,000, respectively, were outstanding under the Credit Facility. The Credit Facility bears interest at either a Eurodollar or Federal Funds rate, plus an applicable margin, which varies from 125 to 200 basis points, depending on Lazard Group's rating as determined by designated credit rating agencies.

The Credit Facility contains affirmative and negative covenants. Such covenants include, among other things, limitations on the ability of Lazard Group to incur debt, grant liens, pay dividends, enter into mergers or to sell all or substantially all of its assets, as well as financial covenants that must be maintained.

**3. SIGNIFICANT ACCOUNTING POLICIES**

The policies below represent recent changes to the Company's significant accounting policies. A complete discussion of the Company's significant accounting policies are included in Lazard Ltd's Form 10-K.

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**Share-Based Payments** In December 2004, the FASB issued SFAS No. 123R, *Share-Based Payments* ( SFAS 123R ). SFAS 123R is a revision of SFAS No. 123, *Accounting for Stock-Based Compensation* ( SFAS 123 ), and supersedes Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* ( APB 25 ), and its related guidance. SFAS 123R is effective for the Company's fiscal year beginning January 1, 2006. Prior to May 10, 2005, the date of the equity public offering, Lazard operated as a series of related partnerships under the control of the partners and Lazard did not have a capital structure that permitted share based compensation. In connection with equity awards granted pursuant to the Company's 2005 Equity Incentive Plan (described in more detail in Note 8 of Notes to Unaudited Condensed Consolidated Financial Statements), the Company adopted the fair value recognition provisions under SFAS 123. Accordingly, subsequent to the dates of grant during 2005, Lazard recognized in compensation expense the amortized portion of the fair value of the equity awards, net of an estimated forfeiture rate, over the service period specified in the award.

Effective for the first quarter of 2006, Lazard adopted SFAS 123R. Under SFAS 123R, share-based awards that do not require future service are expensed immediately. Share-based employee awards that require future service are amortized over the requisite service period. Lazard adopted SFAS 123R under the modified prospective method. Under that method, the provisions of SFAS 123R are applied to share-based awards granted subsequent to adoption. Share-based awards granted to employees prior to the adoption of SFAS 123R must continue to be amortized over the stated service periods of the awards, however, should the awards vest upon retirement, any unamortized cost would be recognized when the employee retires.

Additionally, SFAS 123R changed SFAS 123 by eliminating alternative methods for recognition of the costs of equity awards and recognition of award forfeitures. First, SFAS 123R changed SFAS 123 by precluding the use of the intrinsic method as provided for under APB 25 and requiring fair value recognition. Second, SFAS 123R differed from SFAS 123 by precluding the recognition of forfeitures on an actual basis by requiring the application of an estimated forfeiture rate to the amortizable cost of the award for all unvested awards. The Company adopted both the fair value recognition and the estimated forfeiture rate methods required under SFAS 123R in 2005 while accounting for equity awards under the provisions of SFAS 123.

SFAS 123R also requires that the benefits of tax deductions in excess of recognized compensation costs to be reported as a financing cash flow, rather than as an operating cash flow as prescribed under prior accounting standards. This requirement reduces net operating cash flows and increases net financing cash flows in periods beginning with and subsequent to adoption of SFAS 123R. Total net cash flow remains unchanged from what would have been reported under prior accounting rules.

As a result of the Company adopting certain provisions consistent with SFAS 123R upon the introduction of its 2005 Equity Incentive Plan while under the provisions of SFAS 123, there is no significant effect resulting from the adoption of the provisions of SFAS 123R.

**Investments in Limited Partnerships** On January 1, 2006, the Company adopted, as required, the provisions of Emerging Issues Task Force ( EITF ) Issue No. 04-5, *Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or, Similar Entity When the Limited Partners Have Certain Rights* ( EITF 04-5 ). The EITF consensus requires a general partner in a limited partnership to consolidate the limited partnership unless the presumption of control is overcome. The general partner may overcome this presumption of control and not consolidate the entity if the limited partners have: (a) the substantive ability to dissolve or liquidate the limited partnership or otherwise remove the general partner without having to show cause; or (b) substantive participating rights in managing the partnership. EITF 04-5 was effective for general partners of all newly-formed limited partnerships and for existing limited partnerships for



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which the partnership agreements are modified after June 29, 2005, and for general partners in all other limited partnerships, no later than the beginning of the first reporting period in fiscal years beginning after December 15, 2005. The adoption of the provisions of EITF 04-5 did not have a material impact on the Company's unaudited condensed consolidated financial statements.

**Recent Accounting Pronouncements** In February 2006, the FASB issued SFAS No. 155 *Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140* ( SFAS 155 ). SFAS 155 permits an entity to measure at fair value any financial instrument that contains an embedded derivative that otherwise would require bifurcation. SFAS 155 is effective for all financial instruments acquired or issued in fiscal years beginning after September 15, 2006. The impact of adopting SFAS 155 is not expected to have a material impact on the financial condition, results of operations, and cash flows of the Company.

In March 2006, the FASB issued SFAS No. 156 *Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140* ( SFAS 156 ), which requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable, and for subsequent measurements, permits an entity to choose either the amortization method or the fair value measurement method for each class of separately recognized servicing assets and servicing liabilities. SFAS 156 also requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional disclosures for all separately recognized servicing assets and servicing liabilities. SFAS 156 is effective in fiscal years beginning after September 15, 2006. The impact of adopting SFAS 156 is not expected to have a material impact on the financial condition, results of operations, and cash flows of the Company.

In July 2006, the FASB issued FIN No. 48 *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* ( FIN 48 ), which clarifies the criteria that must be met prior to recognition of the financial statement benefit of a tax position taken in a tax return. FIN 48 provides a benefit recognition model with a two-step approach consisting of a more-likely-than-not recognition criteria, and a measurement attribute that measures the position as the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement. FIN 48 also requires the recognition of liabilities created by differences between tax positions taken in a tax return and amounts recognized in the financial statements. FIN 48 is effective as of the beginning of the first annual period beginning after December 15, 2006. We are currently assessing the impact of adopting FIN 48 on the financial condition, results of operations, and cash flows of the Company.

In September 2006, the FASB issued SFAS No. 157 *Fair Value Measurements* ( SFAS 157 ). SFAS 157 defines fair value, establishes a framework for measuring fair value, and enhances disclosures about fair value measurements. This Statement applies to other accounting pronouncements that require the use of fair value measurements. SFAS 157 is effective for interim and annual financial statements issued for fiscal years beginning after November 15, 2007. We are currently assessing the impact of adopting SFAS 157 on the financial condition, results of operations, and cash flows of the Company.

In September 2006, the FASB issued SFAS No. 158, *Employers Accounting for Defined Benefit Pension and Other Post-Retirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R)* ( SFAS 158 ). SFAS 158 requires an entity to recognize in its statement of financial condition the funded status of its defined benefit post-retirement plans, measured as the difference between the fair value of the plan assets and the applicable benefit obligations. SFAS 158 also requires an entity to recognize changes in the funded status of a defined benefit post-retirement plan within accumulated other comprehensive income, net of tax, to the extent such changes are not recognized in earnings as components of periodic net benefit cost. SFAS 158 is effective for interim and annual financial statements issued for fiscal years ending after December 15, 2006. We are currently assessing the impact of adopting SFAS 158 on the financial condition, results of operations, and cash flows of the Company.

**Table of Contents****LAZARD LTD****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(dollars in thousands, except for per share data, unless otherwise noted)**

In September 2006, the SEC issued Staff Accounting Bulletin No. 108 *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108). SAB 108 permits the Company to adjust for the cumulative effect of immaterial errors relating to prior years in the carrying amount of assets and liabilities as of the beginning of the current fiscal year, with an offsetting adjustment to the opening balance of retained earnings in the year of adoption. SAB 108 also requires the adjustment of any prior quarterly financial statements within the fiscal year of adoption for the effects of such errors on the quarters when the information is next presented. Such adjustments do not require previously filed reports with the SEC to be amended. The Company is currently assessing the impact of adoption of SAB 108 on the financial condition, results of operations, and cash flows as of and for the year ended December 31, 2006.

**4. MINORITY INTEREST**

Minority interest consists of a number of components, including minority interests in LAM and the Company's business in Italy which was owned 40% by Banca Intesa S.p.A. (Intesa) through May 15, 2006 (see Note 5 of Notes to Unaudited Condensed Consolidated Financial Statements). In addition, the Company consolidates various LAM related general partnership interests that it controls but does not wholly own. As a result of consolidating these companies, the Company recognizes the portion of income not associated with the Company's ownership as minority interest.

Payments for services rendered by managing directors of LAM (and employee members of LAM) had, prior to May 10, 2005, been accounted for as minority interest in net income and since that date such payments, together with distributions to profit participation members, have been included in compensation and benefits expense on the unaudited condensed consolidated statements of income.

Commencing May 10, 2005, the Company records a charge to minority interest in net income relating to LAZ-MD Holdings' ownership interest in Lazard Group (which approximated 62.3% and 62.4% at September 30, 2006 and September 30, 2005, respectively), with such minority interest in net income amounting to \$25,278 and \$107,642 for the three month and nine month periods ended September 30, 2006, respectively, and \$36,373 for the three month period ended September 30, 2005 and \$59,186 for the period May 10, 2005 through September 30, 2005. For the reasons stated in this and the two preceding paragraphs, amounts recorded as minority interest in net income for periods prior to May 10, 2005 are not comparable to amounts recorded as minority interest in net income for periods commencing May 10, 2005.

The Company classifies LAZ-MD Holdings' ownership of Lazard Group's common membership interests as a reduction of the Company's additional paid-in capital rather than as minority interest, since the balance of such minority interest as of September 30, 2006 and December 31, 2005 of \$447,470 and \$542,713, respectively, is negative. The change of \$95,243 from December 31, 2005 includes \$69,606 of minority interest share of undistributed net income. See Note 8 of Notes to Unaudited Condensed Consolidated Financial Statements with respect to distributions paid to LAZ-MD Holdings.

**5. STRATEGIC ALLIANCE IN ITALY**

Pursuant to a strategic alliance in effect from January 2003 until its termination, as described below, on May 15, 2006, Lazard Group and Intesa conducted selected Italian investment banking business solely through Lazard & Co. S.r.l. (Lazard Italy), an indirect subsidiary of Lazard Group. As part of the strategic alliance, Intesa:

purchased in March 2003 from Lazard Funding Limited LLC (Lazard Funding), a wholly-owned subsidiary of Lazard Group, a \$150,000 subordinated convertible promissory note (the \$150,000 Subordinated Convertible Note) issued by Lazard Funding, which was convertible into a contractual right that entitled the holder to receive payments that would be equivalent to the distributions that a



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**LAZARD LTD**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(dollars in thousands, except for per share data, unless otherwise noted)**

holder of a three percent equity goodwill interest in Lazard Group would have been entitled to receive (i.e., distributions of the net proceeds of selected fundamental corporate events affecting Lazard Group, such as a sale of all or substantially all of the assets of Lazard Group or a disposition of a line of business);

invested in June 2003 in Lazard Italy an amount of Euros then equal to \$100,000 in exchange for 40% of the capital stock in Lazard Italy (the Intesa JV Interest ); and

purchased in June 2003 a \$50,000 subordinated promissory note issued by Lazard Italy (the \$50,000 Subordinated Promissory Note ). The \$150,000 Subordinated Convertible Note, which was guaranteed by Lazard Group (the Guarantee ), had a scheduled maturity date in March 2018 and had interest payable annually at a variable interest rate of not less than 3%, and not more than 3.25%, per annum. The \$50,000 Subordinated Promissory Note had a scheduled maturity date in the year 2078 (subject to extension), with interest payable annually at the rate of 3.0% per annum.

The proceeds from the sale of capital stock in Lazard Italy exceeded the underlying book value of the net assets purchased by Intesa by approximately \$56,000. This amount had been deferred and included in other liabilities on the unaudited consolidated statement of financial condition as of December 31, 2005 as the Company could have been required to repurchase such amount of capital stock held by Intesa in the event of a termination of the strategic alliance.

On May 15, 2006, Lazard Group completed the termination of its joint venture relationship with Intesa, in accordance with the provisions of the Termination Agreement, dated as of March 31, 2006, by and among Intesa, Lazard Group and Lazard Italy. In connection with the termination, the following adjustments were made to the terms of Intesa's investment in Lazard Italy and Lazard Funding:

The \$150,000 Subordinated Convertible Note, was amended and restated, among other things, to provide for its convertibility into shares of Class A common stock at an effective conversion price of \$57 per share. The amended \$150,000 subordinated convertible note (the Amended \$150,000 Subordinated Convertible Note ) matures on September 30, 2016 and has a fixed interest rate of 3.25% per annum. One-third in principal amount will generally be convertible after July 1, 2008, an additional one-third after July 1, 2009 and the last one-third after July 1, 2010, and no principal amount will be convertible after June 30, 2011. Lazard Ltd will enter into a Registration Rights Agreement with Intesa providing for certain customary registration rights with respect to the shares of Class A common stock Intesa receives upon conversion. The Guaranty by Lazard Group was also amended and restated to reflect the terms of the Amended \$150,000 Subordinated Convertible Note. The covenants and events of default in the Amended \$150,000 Subordinated Convertible Note were not materially changed.

Intesa's 40% equity interest in Lazard Italy and the \$50,000 Subordinated Promissory Note of Lazard Italy held by Intesa were acquired by Lazard Group in exchange for the issuance to Intesa of a \$96,000 senior promissory note of Lazard Group due February 28, 2008 (the \$96,000 Senior Promissory Note ) and a \$50,000 subordinated promissory note of Lazard Group due February 28, 2008 (the \$50,000 Subordinated Promissory Note ), respectively. The \$96,000 Senior Promissory Note and the \$50,000 Subordinated Promissory Note have fixed interest rates of 4.25% and 4.6% per annum, respectively, and each Note contains customary events of default for indebtedness of its type. On May 15, 2006, Intesa sold and assigned all its rights and interests relating to the \$96,000 Senior Promissory Note and the \$50,000 Subordinated Promissory Note to a commercial bank.

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Lazard Group paid Intesa an amount equal to a 3% annualized return on the Intesa JV Interest from April 1, 2006 through the termination closing and the accrued and unpaid interest on the \$50,000 Subordinated Promissory Note as of the termination closing.

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(dollars in thousands, except for per share data, unless otherwise noted)

As a result of the termination of the joint venture relationship and Lazard Group's repurchase of the Intesa JV Interest, the Company realized a gain of \$13,695, excluding transaction and other costs, which is included in revenue other on the unaudited condensed consolidated statements of income for the nine month period ended September 30, 2006 (with all of such gain being recorded in the second quarter of 2006) and, after transaction and other costs, this transaction increased operating income by \$5,274.

**6. SENIOR AND SUBORDINATED DEBT**

**Senior Debt** Senior debt is comprised of the following as of September 30, 2006 and December 31, 2005:

	Principal Amount	Maturity Date	Annual Interest Rate	Outstanding as of	
				September 30, 2006	December 31, 2005
Lazard Group Senior Notes(a)	\$ 550,000	2015	7.125%	\$ 550,000	\$ 550,000
Lazard Group Senior Note(b)	96,000	2008	4.25%	96,000	
Lazard Group Notes issued in connection with the ESUs(a)	437,500	2008-2035(c)	6.12%	437,500	437,500
Revolving Credit Agreement(a)	150,000	2010	5.37%(d)		30,000
Other		2006-2008	Various	12	4,582
Total				\$ 1,083,512	\$ 1,022,082

(a) See Note 2 of Notes to Unaudited Condensed Consolidated Financial Statements for additional information.

(b) See Note 5 of Notes to Unaudited Condensed Consolidated Financial Statements.

(c) Maturity date can vary based on a remarketing of the Lazard Group Notes, and will mature (i) in the event of a successful remarketing, on any date no earlier than May 15, 2010 and no later than May 15, 2035, as we may elect, (ii) in the event of a failed remarketing, on May 15, 2008 and (iii) otherwise on May 15, 2035.

(d) Interest rates vary and are based on either a Federal Funds rate or a Eurodollar rate, in each case plus an applicable margin. As of December 31, 2005, the annual interest rate, including the applicable margin, was 5.37%.

**Subordinated Debt** Subordinated debt at September 30, 2006 and December 31, 2005 amounted to \$200,000 and consist of amounts associated with the strategic alliance transaction in Italy and the termination thereof (see Note 5 of Notes to Unaudited Condensed Consolidated Financial Statements).

As of September 30, 2006, the Company is in compliance with all obligations under its various senior and subordinated borrowing arrangements.

**7. COMMITMENTS AND CONTINGENCIES**

**Commitments** Lazard has various leases and other contractual commitments arising in the ordinary course of business. In the opinion of management, the fulfillment of such commitments in accordance with their terms will not have a material adverse effect on Lazard's consolidated financial position or results of operations.

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During the nine month period ended September 30, 2005, the Company recorded impairment costs of approximately \$6,300 relating to certain abandoned leased facilities in the U.K, which is included in loss from discontinued operations on the unaudited condensed consolidated statement of income (with all of such impairment costs recorded during the first quarter of 2005). These costs represent a provision for lease obligations recorded prior to the lease indemnity from LFCM of \$25,000 (described below) and as such are

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**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(dollars in thousands, except for per share data, unless otherwise noted)**

excluded from the indemnification. In accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, the provision recorded for lease obligations on the cease-use date was determined based on the fair value of the liability for costs that will continue to be incurred for the remaining term of the lease without economic benefit to the Company, based on the remaining lease rentals, reduced by estimated sublease rentals.

With respect to the abandoned facilities discussed above, at September 30, 2006 and December 31, 2005 the Company has recorded liabilities of \$32,394 and \$37,490, respectively, exclusive of the indemnification described below, which are included in other liabilities on the unaudited condensed consolidated statements of financial condition. Payments toward the liabilities continue through the remaining term of the leases. Such liabilities are based on the discounted future commitment, net of expected sublease income.

Under the master separation agreement and a related lease indemnity agreement, dated as of May 10, 2005, by and between LFCM Holdings and one of our London subsidiaries, LFCM Holdings is obligated to indemnify Lazard Group for certain liabilities relating to abandoned leased space in the U.K., up to a maximum of \$29,000. In connection with Lazard Group's entry into subleases with respect to a portion of this abandoned leased space and the incurrence of the related liabilities, during the fourth quarter of 2005 Lazard Group entered into an agreement with LFCM Holdings which provides for LFCM Holdings to pay to Lazard Group \$25,000 in full satisfaction of LFCM's indemnification obligations with respect to the abandoned leased space.

The receivable relating to the indemnity from LFCM Holdings of \$25,000 was recorded at its present value. After payments received in the nine month period ended September 30, 2006 and the year ended December 31, 2005 of \$3,899 and \$6,209, respectively, the net present value of the balance due at September 30, 2006 and December 31, 2005 of \$13,741 and \$17,031, respectively, is included in receivables - related parties on the unaudited condensed consolidated statements of financial condition (see Note 12 of Notes to Unaudited Condensed Consolidated Financial Statements). The balance is due based on a schedule of periodic payments through May 10, 2010.

**Legal** The Company businesses, as well as the financial services industry generally, are subject to extensive regulation throughout the world. The Company is involved in a number of judicial, regulatory and arbitration proceedings and inquiries concerning matters arising in connection with the conduct of our businesses. The Company reviews such matters on a case by case basis and establishes its reserves in accordance with SFAS No. 5, *Accounting For Contingencies*. Management believes, based on currently available information, that the results of such matters, in the aggregate, will not have a material adverse effect on its financial condition but might be material to its operating results or cash flows for any particular period, depending upon the operating results for such period.

The Company received a request for information from the NASD as part of what it understands to be an industry investigation relating to gifts and gratuities, which is focused primarily on the Company's former Capital Markets business, which business was transferred to LFCM Holdings as a part of the separation. In addition, the Company received requests for information from the NASD, SEC and the U.S. Attorney's Office for the District of Massachusetts seeking information concerning gifts and entertainment involving an unaffiliated mutual fund company, which are also focused on that same business. The Company believes that other broker-dealers also received requests for information. In the course of an internal review of these matters, there were resignations or discipline of certain individuals associated with Lazard's former Capital Markets business. These investigations are continuing and the Company cannot predict their potential outcomes. Accordingly, the Company has not recorded an accrual for losses related to any such judicial, regulatory or arbitration proceedings.



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**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(dollars in thousands, except for per share data, unless otherwise noted)**

The Company and Goldman Sachs & Co., the lead underwriter of the Company's equity public offering of its Class A common stock, as well as several members of the Company's management and board of directors, have been named as defendants in several putative class action lawsuits and a putative stockholder derivative lawsuit filed in the U.S. District Court for the Southern District of New York, and in a putative class action lawsuit and a putative stockholder derivative lawsuit filed in the Supreme Court of the State of New York. The plaintiffs in the putative class action lawsuits filed in the U.S. District Court for the Southern District of New York have filed a consolidated amended complaint, and the defendants have filed a motion to dismiss that complaint. The defendants in the putative class action lawsuit filed in the Supreme Court of the State of New York have served plaintiffs with a motion to dismiss the complaint or, in the alternative, stay the action pending resolution of the putative class action in the U.S. District Court for the Southern District of New York. The putative class action lawsuits purport to have been filed on behalf of persons who purchased securities of the Company in connection with the equity public offering or in the open market. The putative class actions allege various violations of the federal securities laws and seek, inter alia, compensatory damages, rescission or rescissory damages and other unspecified equitable, injunctive or other relief. The putative derivative actions purport to be brought on behalf of the Company against its directors and Goldman Sachs & Co. and allege, among other things, that the directors breached their fiduciary duties to the Company in connection with matters related to the equity public offering and seek compensatory damages, punitive damages and other unspecified equitable or other relief. We believe that the suits are without merit and intend to defend them vigorously.

**8. STOCKHOLDERS DEFICIENCY**

Pursuant to Lazard Group's operating agreement as in effect prior to the amended and restated Operating Agreement, Lazard Group allocated and distributed to its members a substantial portion of its distributable profits in three monthly installments, as soon as practicable after the end of each fiscal year. Such installment distributions usually began in February. In addition, other periodic distributions to members included, as applicable, capital withdrawals, fixed return on members' equity and income tax advances made on behalf of members.

In connection with the consummation of the equity public offering, during the period January 1 through May 9, 2005, Lazard Group's members equity was reduced by approximately \$145,000 for the repurchase of working member interests prior to consummation of the equity public offering.

Pursuant to provisions of its amended and restated Operating Agreement, Lazard Group distributions in respect of common membership interests are allocated to the holders of such interests on a pro rata basis. At September 30, 2006, approximately 37.7% and 62.3% of the outstanding Lazard Group common membership interests are held by subsidiaries of the Company and by LAZ-MD Holdings, respectively. Such distributions represent amounts necessary to fund (i) any dividends the Company may declare on its Class A common stock and (ii) tax distributions in respect of income taxes that the Company's subsidiaries and the members of LAZ-MD Holdings incur as a result of holding Lazard Group common membership interests. During the nine month period ended September 30, 2006, Lazard Group distributed \$16,768 to LAZ-MD Holdings and \$10,115 to subsidiaries of Lazard Ltd, which latter amount was used by the Company to pay dividends to third party stockholders of its Class A common stock. In addition, during the nine month period ended September 30, 2006, Lazard Group made tax distributions of \$34,108, including \$21,268 to LAZ-MD Holdings and \$12,840 to subsidiaries of Lazard Ltd.

On October 31, 2006, the Board of Directors of Lazard Ltd declared a quarterly dividend of \$0.09 per share on its Class A common stock, totaling \$3,375, to be paid on November 30, 2006 to stockholders of record on November 10, 2006.

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**(dollars in thousands, except for per share data, unless otherwise noted)**

A description of the Company's 2005 Equity Incentive Plan, and activity with respect thereto during the nine month period ended September 30, 2006 is presented below.

***Shares Available Under the 2005 Equity Incentive Plan (the Equity Incentive Plan)***

The Equity Incentive Plan authorizes the issuance of up to 25,000,000 shares of Class A common stock pursuant to the grant or exercise of stock options, stock appreciation rights, restricted stock, stock units and other equity-based awards. Each stock unit granted under the Equity Incentive Plan represents a contingent right to receive one share of Class A common stock of the Company, at no cost to the recipient. The fair value of such stock unit awards is determined based on the closing market price of the Company's Class A common stock at the date of grant.

***Restricted Stock Unit (RSUs) Grants***

During the nine month period ended September 30, 2006, the Company granted 3,038,483 RSUs to eligible employees. These RSUs include a dividend participation right during the vesting period that provides that each RSU receives additional RSUs (or fractions thereof) equivalent to any ordinary quarterly dividends paid on Class A common stock. During the nine month period ended September 30, 2006, such dividend participation rights required the issuance of 19,034 RSUs, with such issuance resulting in a charge to retained earnings and a credit to additional paid-in-capital, net of forfeitures, of \$726. During the nine month period ended September 30, 2006, 126,428 RSUs granted in 2006 were forfeited, including those relating to the dividend participation rights, as well as an additional 6,400 shares forfeited relating to RSUs granted in 2005.

The RSUs convert into Class A common stock on a one-for-one basis after the stipulated vesting periods. The fair value of the RSUs, net of an estimated forfeiture rate, is amortized over the vesting periods or requisite service periods as required under SFAS 123 or SFAS 123R and, for purposes of calculating diluted net income per share, are included in the diluted weighted average shares of Class A common stock outstanding using the treasury stock method. Expense relating to RSUs is charged to compensation and benefits within the unaudited condensed consolidated statements of income, and amounted to \$6,309 and \$15,544 for the three month and nine month periods ended September 30, 2006, respectively, and \$74 for the three month and nine month periods ended September 30, 2005.

***Deferred Stock Unit (DSUs) Grants***

As part of their compensation for serving as members of the Board of Directors and its various committees, during the nine month period ended September 30, 2006, the Non-Executive Directors of the Company were granted 12,735 DSUs (with such grants inclusive of DSUs granted pursuant to the Directors' Fee Deferral Unit Plan described below). The DSUs include a cash dividend participation right equivalent to any ordinary quarterly dividends paid on Class A common stock. DSU awards are expensed at their full fair value on their date of grant, which totaled \$17 and \$520 during the three month and nine month periods ended September 30, 2006, respectively.

On May 9, 2006, the Board of Directors adopted the Directors' Fee Deferral Unit Plan, which allows the Company's Non-Executive Directors to elect to receive additional DSUs pursuant to the Equity Incentive Plan in lieu of some or all of their cash fees. The number of DSUs that shall be granted to a Non-Executive Director pursuant to this election shall equal the value of cash fees that the applicable Non-Executive Director has elected to forego pursuant to such election, divided by the market value of a share of Class A common stock on the date

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(dollars in thousands, except for per share data, unless otherwise noted)

on which the foregone cash fees would otherwise have been paid. As of September 30, 2006, 414 DSUs were granted pursuant to the Directors Fee Deferral Unit Plan.

The following is a summary of activity relating to RSUs and DSUs during the nine month period ended September 30, 2006:

	RSUs		DSUs	
	Grant Date		Grant Date	
	Weighted		Weighted	
	Average		Average	
	Units	Fair Value	Units	Fair Value
Balance, January 1, 2006	1,033,733	\$ 23.87	9,968	\$ 25.33
Granted (including 19,034 RSUs relating to dividend participation)	3,038,483	\$ 34.73	12,735	\$ 40.82
Forfeited	(132,828)	\$ 34.23		
Converted			(3,668)	\$ 26.89
Balance, September 30, 2006	3,939,388	\$ 31.90	19,035	\$ 35.40

As of September 30, 2006, unrecognized RSU compensation expense, adjusted for estimated forfeitures, was approximately \$84,272, with such compensation expense expected to be recognized over a weighted average period of approximately 3.6 years. The ultimate amount of such expense is dependent upon the actual number of RSUs that will vest. The Company periodically assesses the forfeiture rates used for such estimates. A change in estimated forfeiture rates could cause the aggregate amount of compensation expense recognized in future periods to differ from the estimated unrecognized compensation expense described herein.

**Share Repurchase Program**

On February 7, 2006, the Board of Directors of Lazard Ltd authorized the repurchase of up to \$100,000 in aggregate cost of Lazard Ltd's Class A common stock. The Company's intention is that the share repurchase program will be used primarily to offset shares to be issued under the Equity Incentive Plan. Purchases may be made in the open market or through privately negotiated transactions in 2006 and 2007. During the nine month period ended September 30, 2006, Lazard Group purchased 115,000 shares of Class A common stock in the open market at an average price of \$36.34 per share, which are reported, at cost, as Class A common stock held in treasury on the unaudited condensed consolidated statement of financial condition as of September 30, 2006.

**Preference Shares**

Lazard Ltd currently has 15,000,000 authorized preference shares, par value of \$0.01 per share. As of September 30, 2006, no preference shares have been issued.

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(dollars in thousands, except for per share data, unless otherwise noted)

**9. NET INCOME PER SHARE**

The Company's net income and weighted average shares outstanding for the three month and nine month periods ended September 30, 2006 and 2005 consists of the following:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
Net income	\$ 13,158	\$ 18,603	\$ 56,389	\$ 119,552
Add (deduct) Net income adjustments allocable to members of Lazard Group (for the period January 1, 2005 through May 9, 2005)		408		(89,175)
<b>Net income available for Class A common stockholders</b>	<b>\$ 13,158</b>	<b>\$ 19,011</b>	<b>\$ 56,389</b>	<b>\$ 30,377</b>
Weighted Average Shares Outstanding:				
Basic	37,388,185	37,500,000	37,457,275	37,500,000
Diluted	41,577,615	37,528,978	41,747,068	37,518,513

Net income per share information is not applicable for reporting periods prior to May 10, 2005, the date of the consummation of the equity public offering. The calculations of basic and diluted net income per share amounts for the three month and nine month periods ended September 30, 2006 and 2005 are described and presented below.

**Basic Net Income Per Share**

*Numerator* (i) with respect to 2006, utilizes net income available for Class A common stockholders for the three month and nine month periods ended September 30, 2006, and (ii) with respect to 2005, utilizes net income available for Class A common stockholders for the period May 10, 2005 through September 30, 2005.

*Denominator* (i) with respect to 2006, utilizes the weighted average shares of Class A common stock for the three month and nine month periods ended September 30, 2006, which amount to 37,388,185 and 37,457,275 shares, respectively and (ii) with respect to the three month and nine month periods ended September 30, 2005, utilizes the 37,500,000 weighted average number of shares of Class A common stock outstanding between May 10, 2005 and September 30, 2005.

**Diluted Net Income Per Share**

*Numerator* utilizes net income available for Class A common stockholders for the three month and nine month periods ended September 30, 2006 and 2005 as in the basic net income per share calculation described above, plus, to the extent applicable and dilutive, (i) interest expense on convertible debt, (ii) income adjustments relating to assumed share issuances in connection with DSUs, RSUs and ESUs and (iii) on an as-if-exchanged basis, amounts applicable to LAZ-MD Holdings exchangeable interests, and corporate tax related to (i) (ii) and (iii) herein.

*Denominator* utilizes the weighted average number of shares of Class A common stock for the three month and nine month periods ended September 30, 2006 and 2005 as in the basic net income per share



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(dollars in thousands, except for per share data, unless otherwise noted)

calculation described above, plus, to the extent dilutive, (i) DSU and RSU awards issued to Non-Executive Directors and employees of the Company, respectively, as calculated using the treasury stock method, (ii) convertible debt as calculated using the if converted method, (iii) ESUs using the treasury stock method and (iv) LAZ-MD Holdings exchangeable interests, on an as-if-exchanged basis.

	Three Months Ended		Nine Months Ended	
	September 30, 2006	September 30, 2005	September 30, 2006	September 30, 2005
<b>Basic Net Income Per Share of Class A Common Stock</b>				
Numerator:				
Net income available for Class A common stockholders	\$13,158	\$19,011	\$56,389	\$30,377
Denominator:				
Weighted average number of shares of Class A common stock outstanding	37,388,185	37,500,000	37,457,275	37,500,000
Basic net income per share of Class A common stock	\$0.35	\$0.51	\$1.51	\$0.81
<b>Diluted Net Income Per Share of Class A Common Stock</b>				
Numerator:				
Net income available for Class A common stockholders	\$13,158	\$19,011	\$56,389	\$30,377
Add (deduct) dilutive effect of:				
Adjustments to income relating to assumed changes in income of minority interest resulting from share issuances in connection with DSUs, RSUs and ESUs and interest expense on convertible debt	1,062		4,557	
Additional corporate tax	(182)		(619)	
Diluted net income available for Class A common stockholders	\$14,038	\$19,011	\$60,327	\$30,377
Denominator:				
Basic weighted average number of shares of Class A common stock	37,388,185	37,500,000	37,457,275	37,500,000
Add dilutive effect of:				
Weighted average number of incremental shares issuable from DSUs, RSUs, ESUs and convertible debt	4,189,430	28,978	4,289,793	18,513
Weighted average number of shares of Class A common stock outstanding	41,577,615	37,528,978	41,747,068	37,518,513
Diluted net income per share of Class A common stock	\$0.34	\$0.51	\$1.45	\$0.81

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**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(dollars in thousands, except for per share data, unless otherwise noted)**

During the three month and nine month periods ended September 30, 2006 and 2005, the LAZ-MD Holdings exchangeable interests (which, as of September 30, 2006 and September 30, 2005, represent the right to receive 62,098,448 shares and 62,118,749 shares, respectively, of Class A common stock upon exchange) were antidilutive and consequently the effect of their conversion into shares of Class A common stock has been excluded from the calculation of diluted net income per share of Class A common stock.

Prior to the issuance of the Class A common stock upon settlement of the purchase contracts, the ESUs are reflected in the Company's diluted net income per share using the treasury stock method. Under the treasury stock method, as defined by SFAS No. 128, *Earning Per Share* the number of shares of common stock included in the calculation of diluted income per share is the excess, if any, of the number of shares expected to be issued upon settlement of the purchase contracts less the number of shares that could be purchased by the Company with the proceeds to be received upon settlement at the average market closing price during the reporting period. The number of shares of common stock Lazard Ltd will issue upon settlement of the forward purchase contract component of the ESUs is not fixed, but instead is dependent on the closing price per share of its common stock for each of the 20 trading days beginning on April 15, 2008. Because the settlement terms of the purchase contracts vary, the number of shares to be issued depends on whether the closing price of the stock for the last 20 trading days in the reporting period is less than or equal to \$25 per share, greater than \$25 per share and less than \$30 per share or greater than or equal to \$30 per share. Dilution of income per share will occur (i) in reporting periods when the average stock price is over \$30 per share and (ii) in reporting periods when the average closing price of common stock for a reporting period is greater than \$25 and is greater than the average market price for the last 20 days of such reporting period.

Both the FASB and the EITF continue to study the accounting for financial instruments and derivative instruments, including instruments such as the ESUs. It is possible that the Company's accounting for the ESUs could be affected by any new accounting rules that might be issued by these groups. Accordingly, there can be no assurance that the method in which the ESUs are reflected in the Company's diluted income per share will not change in the future if accounting rules or interpretations evolve.

As discussed in Note 5 of Notes to Unaudited Condensed Consolidated Financial Statements, on May 15, 2006 the Company completed the termination of its joint venture relationship with Intesa. Among its various terms, Lazard Group issued the Amended \$150,000 Subordinated Convertible Note that is convertible into 2,631,585 shares of Class A common stock. The shares potentially issuable under the terms of such note, to the extent dilutive, are included in calculations of the weighted average shares outstanding using the *if converted* method, for purposes of calculating diluted net income per share. Additionally, interest expense, net of income tax, related to such note would be excluded from net income for purposes of calculating net income per share on a diluted basis if an assumed conversion is dilutive.

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(dollars in thousands, except for per share data, unless otherwise noted)

**10. EMPLOYEE BENEFIT PLANS**

The Company, through its subsidiaries, provides retirement and other post-employment benefits to certain of its employees through defined contribution and defined benefit pension plans and other post-retirement benefit plans. The Company has the right to amend or terminate its benefit plans at any time subject to the terms of such plans. Expenses incurred related to the defined benefit pension plans, the defined benefit pension plan supplement and the post-retirement health care plans are included in compensation and benefits and, with respect to the separated businesses, loss from discontinued operations on the unaudited condensed consolidated statements of income. Such expenses for the three month and nine month periods ended September 30, 2006 and 2005 are shown in the tables below.

	Pension Plans	Pension Plan Supplement	Post- Retirement Medical Plans
<b>Three month period ended September 30, 2006</b>			
Service cost	\$ 25		\$ 35
Interest cost	6,293	\$ 15	109
Expected return on plan assets	(7,342)		
Amortization of prior service cost			(363)
Recognized actuarial (gain) loss	427		80
Net periodic benefit cost (credit)	(597)	15	(139)
Settlements and curtailments	135		(2,279)
Total benefit cost (credit)	\$ (462)	\$ 15	\$ (2,418)
<b>Three month period ended September 30, 2005</b>			
Service cost	\$ 1,883		\$ 65
Interest cost	6,413	\$ 22	141
Expected return on plan assets	(6,611)		
Amortization of prior service cost	(109)		(482)
Recognized actuarial (gain) loss	795	(3)	126
Net periodic benefit cost (credit)	2,371	19	(150)
Settlements and curtailments	(1,250)		(2,169)
Total benefit cost (credit)	\$ 1,121	\$ 19	\$ (2,319)
The total benefit cost (credit) is related to continuing and discontinued operations as follows:			
Continuing operations	\$ 2,409	\$ 13	\$ (2,272)
Discontinued operations	(1,288)	6	(47)
	\$ 1,121	\$ 19	\$ (2,319)





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(dollars in thousands, except for per share data, unless otherwise noted)

	Pension Plans	Pension Plan Supplement	Post- Retirement Medical Plans
<b>Nine month period ended September 30, 2006</b>			
Service cost	\$ 1,575		\$ 99
Interest cost	18,408	\$ 47	307
Expected return on plan assets	(21,537)		
Amortization of prior service cost			(1,019)
Recognized actuarial (gain) loss	1,341		240
Net periodic benefit cost (credit)	(213)	47	(373)
Settlements and curtailments	1,045	(7)	(6,332)
Total benefit cost (credit)	\$ 832	\$ 40	\$ (6,705)
<b>Nine month period ended September 30, 2005</b>			
Service cost	\$ 5,841		\$ 196
Interest cost	19,844	\$ 66	427
Expected return on plan assets	(20,439)		
Amortization of prior service cost	(336)		(1,446)
Recognized actuarial (gain) loss	2,468	(9)	379
Net periodic benefit cost (credit)	7,378	57	(444)
Settlements and curtailments	2,710		(6,184)
Total benefit cost (credit)	\$ 10,088	\$ 57	\$ (6,628)
The total benefit cost (credit) is related to continuing and discontinued operations as follows:			
Continuing operations	\$ 8,315	\$ 40	\$ (7,031)
Discontinued operations	1,773	17	403
	\$ 10,088	\$ 57	\$ (6,628)

**LFNY Defined Benefit Pension Plan and Post-Retirement Medical Plan Settlement Transactions** During the three month and nine month periods ended September 30, 2006, the Company recognized a settlement loss of \$135 and \$1,038, respectively, which represents the pro-rata share of actuarial losses attributable to settlements with pension plan participants who elected lump sum payments upon their retirement or discontinuation of service to the Company. Additionally, during the nine month period ended September 30, 2006, the Company recognized a settlement loss of \$303 (all of which occurred in the second quarter of 2006) as a result of the settlement of post-retirement medical plan obligations associated with employees in the separated businesses.

As a result of the separation and in accordance with SFAS No. 88, *Employers Accounting for Settlement and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, the Company recorded a charge of \$3,255 (comprised of \$2,710 and \$545 relating to pension and post-retirement medical plan obligations, respectively), for the nine month period ended September 30, 2005 for the estimated cost relating to the settlement of pension and post-retirement medical plan obligations and special termination benefits to employees in the separated businesses. Of this amount, \$2,420 is included in loss from discontinued operations and \$835 is included in compensation and benefits expense on the unaudited condensed consolidated statements of income. In the three month period ended September 30, 2005, a credit adjustment of \$1,250

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relating to settlement of the pension obligation was recorded and is included in loss from discontinued operations.

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(dollars in thousands, except for per share data, unless otherwise noted)

**Termination of LCH's Post-Retirement Medical Plan** In April 2004, LCH announced a plan to terminate its Post-Retirement Medical Plan. As a result of such action, benefits available to eligible active employees and retirees will cease on February 28, 2007. In accordance with SFAS No. 106, *Employers Accounting for Post-Retirement Benefits Other Than Pensions*, the Company is recognizing the effect of such termination as a reduction of employee compensation and benefits expense over the period ending February 2007. For the three month and nine month periods ended September 30, 2006 and for the three month and nine month periods ended September 30, 2005, compensation and benefits expense was reduced by \$2,279, \$6,635, \$2,169 and \$6,729, respectively, related to the effect of such termination.

**Amendments to LCH Pension Plans** Effective March 31, 2006, the LCH pension plans were amended to cease future accruals. As a result of such amendment, future service and compensation increases will not count for purposes of future benefit accruals under the plans. Vested benefits for active participants as of March 31, 2006 will be retained.

**Employer Contributions and Indemnities from LFCM Holdings** As of December 31, 2005, Lazard Group's principal U.K. pension plans had a combined deficit of approximately \$46,800 (or approximately 27.2 million British pounds). This deficit would ordinarily be funded over time. In the third quarter of 2005, agreements were executed between Lazard Group and the trustees of such pension plans dealing with a plan for the future funding of the deficit as well as with asset allocation. Irrespective of the terms of these agreements, in considering their duties to beneficiaries, the trustees also have the power to change the asset allocation. Any changes in the asset allocation could increase or decrease the unfunded liability that would be funded over time, depending on asset mix, any increase in liabilities and investment returns. In addition, the pensions regulator in the U.K. may have the power to require contributions to be made to plans, and to impose support in respect of the funding of plans by related companies other than the direct obligors. As part of the separation, the Company made a contribution to LFCM Holdings of \$55,000 in connection with the provision by LFCM Holdings of support relating to U.K. pension liabilities and other indemnities.

During the year ended December 31, 2005 and during the second quarter of 2006, contributions of approximately \$29,800 and \$30,500, respectively (equaling 16.4 million British pounds for both periods) were made to the Company's defined benefit pension plans in the U.K., of which 15.0 million British pounds were reimbursed by LFCM Holdings for each period (see Note 12 of Notes to Unaudited Condensed Consolidated Financial Statements). The Company is obligated to make further payments amounting to 8.2 million British pounds on both June 1, 2007 and June 1, 2008.

**11. INCOME TAXES**

Prior to May 10, 2005, the Company was not subject to U.S. federal income taxes. However, the Company was subject to UBT attributable to its operations apportioned in New York City. In addition, certain non-U.S. subsidiaries of the Company were subject to income taxes in their local jurisdictions. Commencing May 10, 2005, a portion of the Company's income is also subject to U.S. federal income tax and the Company's provision for income taxes is accounted for under the provisions of SFAS No. 109, *Accounting for Income Taxes*.

Deferred income taxes reflect the net tax effects of temporary differences between the book and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when such differences are expected to reverse. Such temporary differences are reflected in deferred tax assets and liabilities and are included in other assets and other liabilities, respectively, on the unaudited condensed consolidated statements of financial condition.

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**LAZARD LTD**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(dollars in thousands, except for per share data, unless otherwise noted)**

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of the deferred tax assets is dependent upon the generation of future taxable income during the periods in which temporary differences become deductible. Management considers the level of historical taxable income, scheduled reversals of deferred taxes, projected future taxable income and tax planning strategies that can be implemented by the Company in making this assessment.

The Company's provision for income taxes for the three month and nine month periods ended September 30, 2006 and for the three month and nine month periods ended September 30, 2005 was \$10,153, \$44,827, \$17,177 and \$50,443, respectively, representing effective tax rates on operating income from continuing operations of 20.6%, 21.1%, 22.2% and 19.0%, respectively.

For the three month and nine month periods ended September 30, 2006, the effective tax rates of 20.6% and 21.1%, respectively, are blended rates comprised of (i) an estimated 28.0% effective rate applicable to Lazard Ltd's ownership interest in Lazard Group's operating income from continuing operations (less its applicable share of LAM general partnership related revenues) in each period and (ii) Lazard Group's estimated effective tax rates of 16.4% and 17.3% applicable to the remaining ownership interest in Lazard Group for the respective periods.

For the three month and nine month periods ended September 30, 2005, the effective tax rates of 22.2% and 19.0%, respectively, are blended rates comprised of (i) an estimated 28.0% effective tax rate applicable to Lazard Ltd's ownership interest in Lazard Group's operating income from continuing operations for the period May 10, 2005 through September 30, 2005 and (ii) Lazard Group's estimated effective tax rates of 19.0% and 17.2% applicable to the remaining ownership interest in Lazard Group for the respective periods.

With respect to Lazard Ltd's ownership interest in Lazard Group, the difference between the U.S. federal statutory rate of 35% and the estimated effective tax rate of 28.0% for the three month and nine month periods ended September 30, 2006 and for the period from May 10, 2005 through September 30, 2005, principally relates to foreign source income not subject to U.S. income taxes and the amortization associated with the tax basis step-up resulting from the separation and recapitalization, partially offset by U.S. state and local taxes, which are incremental to the U.S. federal statutory tax rate.

With respect to the ownership interests in Lazard Group not held by Lazard Ltd, the difference between the U.S. federal statutory tax rate of 35% and Lazard Group's estimated effective tax rates of 16.4% and 17.3% for the three month and nine month periods ended September 30, 2006, respectively, and 19.0% and 17.2% for the three month and nine month periods ended September 30, 2005, respectively, is principally due to Lazard Group's U.S. limited liability company status, which is treated as a partnership for U.S. federal income tax purposes. As a result, Lazard Group's income is not subject to U.S. federal income taxes because taxes associated with its income represent obligations of the individual partners. Outside the U.S., Lazard Group operates principally through subsidiary corporations that are subject to local income taxes. Additionally, Lazard Group is subject to UBT attributable to Lazard Group's operations apportioned to New York City which are incremental to the U.S. federal statutory tax rate.

***Tax Receivable Agreement***

The redemption of historical partner interests in connection with the separation and recapitalization has resulted, and the exchanges of LAZ-MD Holdings exchangeable interests for shares of Class A common stock may result, in increases in the tax basis of the tangible and/or intangible assets of Lazard Group. The tax receivable

**Table of Contents****LAZARD LTD****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(dollars in thousands, except for per share data, unless otherwise noted)

agreement, dated as of May 10, 2005, with LFCM Holdings requires the Company to pay LFCM Holdings 85% of the cash savings, if any, in U.S. federal, state and local income tax or franchise tax that the Company actually realizes as a result of the above-mentioned increases in tax basis. During the fourth quarter of 2005, the Company recorded a provision of \$2,685 pursuant to the tax receivable agreement, with the liability related thereto included within payable to related parties as of September 30, 2006 and December 31, 2005 on the unaudited condensed consolidated statements of financial position. The Company calculates this provision annually once the results of operations for the full year are known. As a result, there is no provision for such payments in the three month and nine month periods ended September 30, 2006 and 2005. If any provision is required pursuant to the tax receivable agreement, such amount would be fully offset by a reduction in the Company's income tax expense.

**12. RELATED PARTIES**

Amounts receivable from and payable to related parties as of September 30, 2006 and December 31, 2005 are set forth below:

	September 30, 2006	December 31, 2005
<b>Receivables</b>		
LFCM Holdings	\$ 16,993	\$ 53,787
LAZ-MD Holdings		145
Total	\$ 16,993	\$ 53,932
<b>Payables</b>		
LFCM Holdings	\$ 3,430	\$ 3,919

**LFCM Holdings**

LFCM Holdings owns and operates the separated businesses and is owned by the working members, including Lazard's managing directors (which also include our executive officers) who are also members of LAZ-MD Holdings. In addition to the master separation agreement which effected the separation and recapitalization as discussed in Note 1 of Notes to Unaudited Condensed Consolidated Financial Statements, LFCM Holdings entered into an insurance matters agreement and a license agreement that addressed various business matters associated with the separation, as well as several other agreements discussed below.

Under the employee benefits agreement, dated as of May 10, 2005, by and among Lazard Ltd, Lazard Group, LAZ-MD Holdings and LFCM Holdings, LFCM Holdings generally assumed, as of the completion of the separation and recapitalization transactions, all outstanding and future liabilities in respect of the current and former employees of the separated businesses. The Company retained all accrued liabilities under, and assets of, the pension plans in the U.S. and the U.K. as well as the 401(k) Plan accounts of the inactive employees of LFCM Holdings and its subsidiaries. See Note 10 of Notes to Unaudited Condensed Consolidated Financial Statements for additional information regarding employer contributions and indemnities from LFCM Holdings.

Pursuant to the administrative services agreement dated as of May 10, 2005, by and among LAZ-MD Holdings, LFCM Holdings and Lazard Group (the administrative services agreement), Lazard Group provides selected administrative and support services to LAZ-MD Holdings and LFCM Holdings, such as cash management and debt service administration, accounting and financing activities, tax, payroll, human resources administration, financial transaction support, information technology, public communications, data processing, procurement, real estate management, and other general administrative functions. Lazard Group charges for these services based on Lazard Group's cost allocation

methodology.

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**LAZARD LTD**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(dollars in thousands, except for per share data, unless otherwise noted)**

The services provided by Lazard Group to LFCM Holdings and by LFCM Holdings to Lazard Group under the administrative services agreement generally will be provided until December 31, 2008. LFCM Holdings and Lazard Group have a right to terminate the services earlier if there is a change of control of either party or the business alliance provided in the business alliance agreement expires or is terminated. The party receiving a service may also terminate a service earlier upon 180 days' notice as long as the receiving party pays the service provider an additional three months of service fee for terminated service.

The business alliance agreement provides that Lazard Group will refer to LFCM Holdings selected opportunities for underwriting and distribution of securities. In addition Lazard Group will provide assistance in the execution of any such referred business. In exchange for the referral obligation and assistance, Lazard Group will receive a referral fee from LFCM Holdings equal to approximately half of the revenue obtained by LFCM Holdings in respect of any underwriting or distribution opportunity. In addition, LFCM Holdings will refer opportunities in the Financial Advisory and Asset Management businesses to Lazard Group. In exchange for this referral, LFCM Holdings will be entitled to a customary finders' fee from Lazard Group. The business alliance agreement further provides that, during the term of the business alliance, LFN and LAM Securities, subsidiaries of Lazard Group, will introduce execution and settlement transactions to newly-formed broker-dealer entities affiliated with LFCM Holdings. The term of the business alliance will expire on the fifth anniversary of the equity public offering, subject to periodic automatic renewal, unless either party elects to terminate in connection with any such renewal or elects to terminate on account of a change of control of either party.

For the three month and nine month periods ended September 30, 2006, amounts recorded by Lazard Group relating to administrative and support services amounted to \$1,940 and \$3,997, respectively, and referral fees for underwriting transactions amounted to \$1,044 and \$3,297, respectively. For the three month period ended September 30, 2005, amounts recorded by Lazard Group relating to administrative and support services and referral fees for underwriting transactions amounted to \$1,761 and \$1,630, respectively, and for the period May 10, 2005 through September 30, 2005, amounts recorded by Lazard Group relating to administrative and support services and referral fees for underwriting transactions amounted to \$2,215 and \$2,544, respectively. Such amounts are reported as reductions to operating expenses and as underwriting revenue, respectively.

Receivables from LFCM Holdings and its subsidiaries as of September 30, 2006 and December 31, 2005 include \$13,741 and \$17,031, respectively, related to the lease indemnity agreement, and \$26,800 as of December 31, 2005 related to the U.K. pension indemnity. During the second quarter of 2006, the Company received \$26,800 from LFCM for the settlement of the U.K. pension indemnity. The remaining receivables of \$3,252 and \$9,956 at September 30, 2006 and December 31, 2005, respectively, relate primarily to administrative and support services and reimbursement of expenses paid on behalf of LFCM Holdings (\$1,600 and \$2,615 as of September 30, 2006 and December 31, 2005, respectively) and referral fees for underwriting transactions (\$1,403 and \$6,307 as of September 30, 2006 and December 31, 2005, respectively). Payables to LFCM Holdings and its subsidiaries at September 30, 2006 and December 31, 2005 include \$2,685 pursuant to the tax receivable agreement described in Note 11 of Notes to Unaudited Condensed Consolidated Financial Statements.

**LAZ-MD Holdings**

As of September 30, 2006, LAZ-MD Holdings holds an approximate 62.3% common membership interest in Lazard Group and Lazard Ltd holds the remaining 37.7% common membership interest. Additionally, LAZ-MD Holdings is the sole owner of the one issued and outstanding share of Class B common stock (the "Class B common stock") of Lazard Ltd. As of September 30, 2006, the Class B common stock provides LAZ-MD Holdings with



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**LAZARD LTD**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(dollars in thousands, except for per share data, unless otherwise noted)**

approximately 62.3% of the voting power but no economic rights in Lazard Ltd. Subject to certain limitations, LAZ-MD Holdings exchangeable interests are exchangeable for Class A common stock. However, the Class B common stock will represent no less than 50.1% of the voting power until December 31, 2007.

Lazard Group provides selected administrative and support services to LAZ-MD Holdings through the administrative services agreement as discussed above. Lazard Group charges LAZ-MD Holdings for these services based on Lazard Group's cost allocation methodology and, for the three month and nine month periods ended September 30, 2006 such charges amounted to \$50 and \$150, respectively. For the period May 10, 2005 through September 30, 2005, Lazard Group's charges to LAZ-MD Holdings for such services were not material.

**13. REGULATORY AUTHORITIES**

LFNY is a U.S. registered broker-dealer and is subject to the net capital requirements of Rule 15c3-1 under the Securities Exchange Act of 1934, as amended (the Exchange Act). Under the basic method permitted by this rule, the minimum required net capital, as defined, is a specified fixed percentage of total aggregate indebtedness recorded on LFNY's statement of financial condition, or \$5, whichever is greater. At September 30, 2006, LFNY's regulatory net capital was \$42,380, which exceeded the minimum requirement by \$37,138.

Certain U.K. subsidiaries of the Company, including LCL, Lazard Fund Managers Limited and Lazard Asset Management Limited (the U.K. Subsidiaries) are regulated by the Financial Services Authority (the FSA). The Company presently estimates that at September 30, 2006, the aggregate regulatory net capital of the U.K. Subsidiaries was \$164,896, which exceeded the minimum requirement by \$99,885.

The Financial Advisory activities of Lazard Frères SAS (LF) and its wholly-owned subsidiaries, including LFB, are authorized by the Comité des Etablissements de Crédit et des Entreprises d'Investissement and are regulated by the Comité de la Réglementation Bancaire et Financière. Supervision is exercised by the Commission Bancaire, which is responsible, in liaison with the Banque de France, for ensuring compliance with the regulations. In this context LF has the status of a bank holding company (Compagnie Financière) and LFB is a registered bank (Etablissement de Crédit). In addition, the investment services activities of the Paris group, exercised through LFB and other subsidiaries, primarily LFG (asset management) and Fonds Partenaires Gestion (private equity, merchant banking), are subject to regulation and supervision by the Autorité des Marchés Financiers. At September 30, 2006, the consolidated regulatory net capital of LF was \$159,722, which exceeded the minimum requirement set for regulatory capital levels by \$67,082.

Certain other U.S. and non-U.S. subsidiaries are subject to various other capital adequacy requirements promulgated by various regulatory and exchange authorities in the countries in which they operate. At September 30, 2006, for those subsidiaries with regulatory capital requirements, their aggregate net capital was \$40,587, which exceeded the minimum required capital by \$29,252.

During the nine month period ended September 30, 2006, each of these subsidiaries individually was in compliance with its regulatory capital requirements.

**14. SEGMENT OPERATING RESULTS**

The Company's reportable segments offer different products and services and are managed separately as different levels and types of expertise are required to effectively manage the segments' transactions. Each segment is reviewed to determine the allocation of resources and to assess its performance. Prior to May 10, 2005, the Company's business results were categorized into the following three segments: Financial Advisory, Asset Management and Capital Markets and Other. On May 10, 2005 the Capital Markets and Other segment



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**LAZARD LTD**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(dollars in thousands, except for per share data, unless otherwise noted)**

was disposed of in connection with the separation as discussed in Note 1 of Notes to Unaudited Condensed Consolidated Financial Statements. Consequently, subsequent to May 10, 2005, the Company has two segments: Financial Advisory which includes providing advice on mergers and acquisitions, restructurings, capital raising and similar transactions, and Asset Management which includes the management of equity and fixed income securities and merchant banking funds. Capital Markets and Other consisted of equity, fixed income and convertibles sales and trading, broking, research and underwriting services, merchant banking fund management activities outside of France and specified non-operating assets and liabilities. In addition, the Company records selected other activities in Corporate, including cash and marketable investments, certain long-term investments, and the commercial banking activities of LFB. The Company also allocates outstanding indebtedness to Corporate.

As discussed in Note 1 of Notes to Unaudited Condensed Consolidated Financial Statements, historical results of operations are reported as an historical partnership until the equity public offering on May 10, 2005 and do not include payments for services rendered by managing directors as compensation expense and a provision for U.S. federal income taxes. Such payments and tax provisions are included in subsequent periods. Therefore, historical results for periods prior to the equity public offering on May 10, 2005 and subsequent thereto are not comparable.

The Company's segment information for the three month and nine month periods ended September 30, 2006 and 2005 is prepared using the following methodology:

Revenue and expenses directly associated with each segment are included in determining operating income.

Expenses not directly associated with specific segments are allocated based on the most relevant measures applicable, including headcount, square footage and other factors.

Segment assets are based on those directly associated with each segment, and include an allocation of certain assets relating to various segments, based on the most relevant measures applicable, including headcount, square footage and other factors.

The Company allocates investment gains and losses, interest income and interest expense among the various segments based on the segment in which the underlying asset or liability is reported.

Each segment's operating expenses include (i) compensation and benefits expenses, including amounts for certain senior advisors that are incurred directly in support of the businesses, and (ii) other operating expenses, which include directly incurred expenses for premises and occupancy, professional fees, travel and entertainment, communications and information services, equipment and indirect support costs (including compensation and other operating expenses related thereto) for administrative services. Such administrative services include, but are not limited to, accounting, tax, legal, facilities management and senior management activities.

**Table of Contents****LAZARD LTD****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(dollars in thousands, except for per share data, unless otherwise noted)

Management evaluates segment results based on net revenue and operating income and believes that the following information provides a reasonable representation of each segment's contribution to continuing operations with respect to net revenue, operating income and total assets:

		Three Months Ended		Nine Months Ended	
		September 30,		September 30,	
		2006	2005	2006	2005
Financial Advisory	Net Revenue	\$ 187,050	\$ 257,785	\$ 671,245	\$ 626,610
	Operating Expenses	142,696	174,754	498,619	412,639
	Operating Income	\$ 44,354	\$ 83,031	\$ 172,626	\$ 213,971
Asset Management	Net Revenue	\$ 125,388	\$ 110,994	\$ 376,792	\$ 326,695
	Operating Expenses	103,080	90,935	294,512	244,970
	Operating Income	\$ 22,308	\$ 20,059	\$ 82,280	\$ 81,725
Corporate	Net Revenue	\$ (14,926)	\$ (11,876)	\$ (27,359)	\$ (18,940)
	Operating Expenses	2,543	13,925	15,545	11,478
	Operating Income (Loss)	\$ (17,469)	\$ (25,801)	\$ (42,904)	\$ (30,418)
Total	Net Revenue	\$ 297,512	\$ 356,903	\$ 1,020,678	\$ 934,365
	Operating Expenses	248,319	279,614	808,676	669,087
	Operating Income	\$ 49,193	\$ 77,289	\$ 212,002	\$ 265,278

		As of	
		September 30,	December 31,
		2006	2005
Total Assets:			
Financial Advisory		\$ 363,767	\$ 336,576
Asset Management		331,358	308,054
Corporate		1,336,136	1,266,267
Total		\$ 2,031,261	\$ 1,910,897

**15. DISCONTINUED OPERATIONS**

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Loss from discontinued operations for the three and nine month periods ended September 30, 2005 was comprised of the following:

	<b>Three Months Ended</b>	<b>Nine Months Ended</b>
	<b>September 30, 2005</b>	<b>September 30, 2005</b>
Net revenue	\$ (1,079)	\$ 39,599
Pre-tax loss	\$ (155)	\$ (14,246)
Provision for income taxes	253	3,330
Loss from discontinued operations (net of tax)(*)	\$ (408)	\$ (17,576)

(\*) Borne by the members of Lazard Group as such losses were incurred prior to May 10, 2005, the date of the Company's equity public offering and the separation and recapitalization transactions.

\* \* \* \* \*

**Table of Contents****Item 1A. Pro Forma Financial Information (Unaudited)**

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Unaudited Pro Forma Condensed Consolidated Statement of Income For The Nine Month Period Ended September 30, 2005	39

As described below and elsewhere in this quarterly report on Form 10-Q, the historical results of operations for periods prior to May 10, 2005, the date of our equity public offering, are not comparable to results of operations for subsequent periods. Accordingly, for periods prior to May 10, 2005, Lazard believes that pro forma results provide the most meaningful basis for comparison of historical periods.

The following unaudited pro forma condensed consolidated statement of income for the nine month period ended September 30, 2005 present the consolidated results of operations of Lazard Group and Lazard Ltd assuming that the separation and recapitalization transactions, including the equity public offering and the financing transactions, had been completed as of January 1, 2005. The pro forma adjustments are based on available information and upon assumptions that our management believes are reasonable in order to reflect, on a pro forma basis, the impact of the separation and recapitalization transactions, including the equity public offering and the financing transactions, on the historical financial information of Lazard. The adjustments are described in the notes to the unaudited pro forma condensed consolidated statement of income and principally include the matters set forth below.

The separation, which is described in more detail in Management's Discussion and Analysis of Financial Condition and Results of Operations and the accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

Payment for services rendered by Lazard Group's managing directors, which, as a result of Lazard Group operating as a limited liability company, prior to May 10, 2005 has been accounted for as distributions from members' capital, or in some cases as minority interest, rather than as compensation and benefits expense and distributions to profit participation members. As a result, Lazard Group's operating income prior to May 10, 2005 included within the accompanying unaudited condensed consolidated financial statements did not reflect payments for services rendered by its managing directors. For periods subsequent to the consummation of the equity public offering, as described in Note 1 of Notes to Unaudited Condensed Consolidated Financial Statements, Lazard now includes all payments for services rendered by its managing directors and distributions to profit participation members in compensation and benefits expense.

U.S. corporate federal income taxes, since Lazard Group has operated in the U.S. as a limited liability company that was treated as a partnership for U.S. federal income tax purposes. As a result, Lazard Group's income had not been subject to U.S. federal income taxes. Taxes related to income earned by partnerships represent obligations of the individual partners. Outside the U.S., Lazard Group historically has operated principally through subsidiary corporations and has been subject to local income taxes. Prior to May 10, 2005, income taxes reflected within Lazard Group's results of operations included within the accompanying unaudited condensed consolidated financial statements are attributable to taxes incurred in non-U.S. entities and to UBT attributable to Lazard Group's operations apportioned to New York City. For periods subsequent to the equity public offering, the consolidated financial statements of Lazard Ltd include U.S. corporate federal income taxes on its allocable share of Lazard Group's results of operations, giving effect to the post equity public offering structure.

Minority interest in net income reflecting ownership by LAZ-MD Holdings of Lazard Group common membership interests outstanding immediately after the equity public offering and the separation and recapitalization transactions on May 10, 2005. Prior to that date, Lazard Ltd had no ownership interest in Lazard Group and all net income was allocable to the then members of Lazard Group. LAZ-MD Holdings is a holding company that is owned by current and former managing directors of Lazard Group.

The use of proceeds from the financing transactions.

The net incremental expense related to the financing transactions and the exclusion of certain one-time equity public offering-related costs.



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The unaudited pro forma financial information of the Company should be read together with the accompanying Management's Discussion and Analysis of Financial Condition and Results of Operations and Lazard's historical unaudited condensed consolidated financial statements and the related notes included elsewhere herein.

The unaudited pro forma condensed consolidated financial information is included for informational purposes only and does not purport to reflect the results of operations of Lazard Group or Lazard Ltd that would have occurred had they operated as separate, independent companies during the period presented. Actual results might have differed from pro forma results if Lazard Group or Lazard Ltd had operated independently. The unaudited pro forma condensed consolidated financial information should not be relied upon as being indicative of Lazard Group or Lazard Ltd's results of operations had the transactions described in connection with the separation and recapitalization transactions, including the equity public offering and the financing transactions, been completed on January 1, 2005. The unaudited pro forma condensed consolidated financial information also does not project the results of operations for any future period or date.



**Table of Contents****LAZARD LTD****UNAUDITED PRO FORMA CONDENSED CONSOLIDATED STATEMENT OF INCOME**

Nine Month Period Ended September 30, 2005

	Historical	Pro Forma Adjustments	Total	Pro Forma Adjustments For The Other Financing Transactions	Lazard Ltd Pro Forma, as Adjusted	Pro Forma Adjustments For The Equity Public Offering	Lazard Ltd Pro Forma, as Adjusted
(\$ in thousands, except per share data)							
Total revenue	\$ 987,906		\$ 987,906		\$ 987,906		\$ 987,906
Interest expense	(53,541)(a)	\$ 1,661(b)	(51,880)	\$ (22,626)(e)	(74,506)		(74,506)
Net revenue	934,365	1,661	936,026	(22,626)	913,400		913,400
Operating Expenses:							
Compensation and benefits, and, commencing May 10, 2005, distributions to profit participation members	482,228	75,476(c)	557,704		557,704		557,704
Premises and occupancy costs	50,513		50,513		50,513		50,513
Professional fees	36,111	(2,935)(b)	33,176		33,176		33,176
Travel and entertainment	30,768		30,768		30,768		30,768
Other	69,467		69,467		69,467		69,467
Operating expenses	669,087	72,541	741,628		741,628		741,628
Operating income from continuing operations	265,278	(70,880)	194,398	(22,626)	171,772		171,772
Provision (benefit) for income taxes	50,443	463(d)	50,906	(8,515)(f)	42,391	\$ (946)(g)	41,445
Income allocable to members before minority interest in net income	214,835	(71,343)	143,492	(14,111)	129,381	946	130,327
Minority interest in net income	77,707	(9,081)(c)	68,626		68,626	18,987(h)	87,613
Income from continuing operations	\$ 137,128	\$ (62,262)	\$ 74,866	\$ (14,111)	\$ 60,755	\$ (18,041)	\$ 42,714
Weighted average shares outstanding:							
Basic			99,907,829(i)				37,500,000(k)
Diluted			99,907,829(i)				37,509,765(k)
Net income per share:							
Basic			\$0.75(j)				\$1.14(l)
Diluted			\$0.75(j)				\$1.14(l)

See Notes to Unaudited Pro Forma Condensed Consolidated Statement of Income

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*Notes to Unaudited Pro Forma Condensed Consolidated Statement of Income (\$ in thousands):*

- (a) Interest expense includes a credit of \$8,000 which represents accrued dividends relating to Lazard Group's mandatorily redeemable preferred stock which were cancelled in connection with the redemption of membership interests of historical partners.
- (b) Represents adjustments to exclude non-recurring, one-time costs related to the separation and recapitalization, which consisted of interest of \$1,661 and professional fees of \$2,935.
- (c) Prior to the equity public offering, payments for services rendered by the Company's managing directors were accounted for as distributions from members' capital, or as minority interest in net income in the case of payments to LAM managing directors and certain key LAM employee members through May 9, 2005, rather than as compensation and benefits expense. As a result, the Company's compensation and benefits expense and income from continuing operations did not reflect most payments for services rendered by Lazard Group's managing directors. See Management's Discussion and Analysis of Financial Condition and Results of Operations Key Financial Measures and Indicators Net Income (Net Income Allocable to Members of Lazard Prior to May 10, 2005).

The adjustment reflects the classification of those payments for services rendered prior to May 10, 2005 as compensation and benefits expense and has been determined as if the new compensation policy described below had been in place prior to May 10, 2005. Accordingly, the unaudited pro forma condensed consolidated statement of income data reflects compensation and benefits expense based on new retention agreements that are in effect.

Following the completion of the equity public offering, the Company's policy is that its compensation and benefits expense, including that payable to its managing directors, will not exceed 57.5% of operating revenue each year (although the Company retains the ability to change this policy in the future). The Company's managing directors have been informed of this new policy. The new retention agreements with its managing directors generally provide for a fixed salary and discretionary bonus, which may include an equity-based compensation component. Lazard defines operating revenue for these purposes as consolidated total gross revenue less interest expense related to LFB, our Paris-based banking affiliate and certain revenue related to the consolidation of LAM general partnerships, with such operating revenue being \$969,920.

The overall net adjustment to increase historical compensation and benefits expense is \$75,476. The net adjustments are the result of aggregating the distributions representing payments for services rendered by managing directors and employee members of LAM prior to May 10, 2005.

- (d) Represents a net tax expense of \$463 which reflects the application of the historical effective Lazard Group income tax rates against the applicable pro forma adjustments, which was \$758, and a \$295 tax benefit reclassified from LAM minority interest.
- (e) Reflects net incremental interest expense related to the separation and recapitalization transactions, including the financing transactions and the amortization of capitalized costs associated with the financing transactions.
- (f) Reflects the net income tax impact associated with the separation and recapitalization transactions.
- (g) Represents an adjustment for Lazard Ltd entity-level taxes of \$946.

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The difference between the U.S. federal statutory tax rate of 35% and Lazard Ltd's estimated effective tax rate of 28% is primarily due to the earnings attributable to Lazard Ltd's non-U.S. subsidiaries being taxable at rates lower than the U.S. federal statutory tax rate, partially offset by U.S. state and local taxes which are incremental to the U.S. federal statutory tax rate.

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- (h) Minority interest in net income includes an adjustment for LAZ-MD Holdings' ownership of Lazard Group common membership interests with such minority interest being the result of multiplying LAZ-MD Holdings' ownership interests in Lazard Group, which, for pro forma purposes, was assumed to be 62.5% for the period January 1, 2005 through July 26, 2005, with a subsequent reduction to approximately 62.4% for the remainder of the nine month period ended September 30, 2005. LAZ-MD Holdings' ownership interests in Lazard Group are exchangeable, on a one-for-one basis, into shares of Class A common stock, and, on a fully exchanged basis, would amount to 62,118,749 shares of Class A common stock, or approximately 62.4% of Lazard Ltd's shares of Class A common stock outstanding, as of September 30, 2005.
- (i) For purposes of presentation of basic and diluted net income per share of Class A common stock, it was assumed that all Lazard Group common membership interests were exchanged into 99,907,829 shares of Class A common stock. These shares consider the repurchase in the quarter ended September 30, 2005 of Lazard Group common membership interests held by LAZ-MD Holdings that were exchangeable for the equivalent of 381,251 shares of Class A common stock.
- (j) Calculated based on the weighted average basic and diluted shares outstanding, as applicable, as described in note (i) above. Net income per share of Class A common stock is not comparable to Lazard Ltd pro forma as adjusted net income per share of Class A common stock due to the effect of the recapitalization, including the equity public offering and the financing transactions, and because income from continuing operations does not reflect U.S. corporate federal income taxes since Lazard Group has operated in the U.S. as a limited liability company that was treated as a partnership for U.S. federal tax purposes, whereas Lazard Ltd income from continuing operations includes a provision in respect of such taxes.
- (k) For basic net income per share of Class A common stock, the weighted average shares outstanding reflects the 37,500,000 shares of Class A common stock outstanding immediately following the equity public offering and the IXIS private placement and recapitalization. For diluted net income per share of Class A common stock, weighted average shares outstanding include incremental shares issuable from non-vested stock unit awards. LAZ-MD Holdings exchangeable interests are not included on an as-if-exchanged basis because such exchangeable interests were antidilutive. Shares issuable with respect to the exercise of the purchase contracts associated with the equity security units offered in the ESU offering and the IXIS ESU placement are not included because, under the treasury stock method of accounting, such securities were not dilutive.
- (l) Calculated after considering the impact of all the pro forma adjustments described above and based on the weighted average basic and diluted shares outstanding, as applicable, as described in note (k) above. See the table below for a detailed reconciliation of pro forma basic to pro forma diluted net income per share of Class A common stock.

	Nine Months Ended September 30, 2005		
	Pro Forma		
	Weighted		Income from
	Average Shares	Income from	Continuing Operations
	Outstanding	Continuing	per share of
		Operations	Class A Common Stock
		(\$ in thousands, except per share data)	
Amounts as reported for Basic net income per share of Class A common stock	37,500,000	\$42,714	\$1.14
Restricted stock units	9,765		
Amounts as reported for Diluted net income per share of Class A common stock	37,509,765	\$42,714	\$1.14



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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*The following discussion should be read in conjunction with Lazard Ltd's unaudited condensed consolidated financial statements and the related notes included elsewhere in this Form 10-Q.*

**Forward-Looking Statements and Certain Factors that May Affect Our Business**

Management has included in Parts I and II of this Quarterly Report on Form 10-Q, including in its Management's Discussion and Analysis of Financial Condition and Results of Operations (the "MD&A"), statements that are forward-looking statements. In some cases, you can identify these statements by forward-looking words such as may, might, will, should, expect, plan, anticipate, believe, estimate, predict, continue, and the negative of these terms and other comparable terminology. These forward-looking statements, which are subject to known and unknown risks, uncertainties and assumptions about us, may include projections of our future financial performance based on our growth strategies and anticipated trends in our business. These statements are only predictions based on our current expectations and projections about future events. There are important factors that could cause our actual results, level of activity, performance or achievements to differ materially from the results, level of activity, performance or achievements expressed or implied by the forward-looking statements. These factors include, but are not limited to, those discussed in our Annual Report on Form 10-K for the year ended December 31, 2005 (the "Form 10-K") under the caption "Risk Factors," including the following:

a decline in general economic conditions or the global financial markets,

losses caused by financial or other problems experienced by third parties,

losses due to unidentified or unanticipated risks,

a lack of liquidity, *i.e.*, ready access to funds, for use in our businesses, and

competitive pressure.

The Company operates in a very competitive and rapidly changing environment. New risks and uncertainties emerge from time to time, and it is not possible for our management to predict all risks and uncertainties, nor can management assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

Although management believes the expectations reflected in the forward-looking statements are reasonable, management cannot guarantee future results, level of activity, performance or achievements. Moreover, neither management nor any other person assumes responsibility for the accuracy or completeness of any of these forward-looking statements. You should not rely upon forward-looking statements as predictions of future events. The Company is under no duty to update any of these forward-looking statements after the date of this Quarterly Report on Form 10-Q to conform our prior statements to actual results or revised expectations and does not intend to do so.

Forward-looking statements include, but are not limited to, statements about the:

business possible or assumed future results of operations and operating cash flows,

business strategies and investment policies,

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business financing plans and the availability of short-term borrowing,

business competitive position,

potential growth opportunities available to our businesses,

recruitment and retention of managing directors and employees,

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target levels of compensation,

business potential operating performance, achievements, productivity improvements, efficiency and cost reduction efforts,

likelihood of success and impact of litigation,

expected tax rate,

changes in interest and tax rates,

expectation with respect to the economy, securities markets, the market for mergers and acquisitions activity, the market for asset management activity and other industry trends,

effects on our businesses resulting from the separation and recapitalization transactions, including the equity public offering and the financing transactions,

effects of competition on our businesses, and

impact of future legislation and regulation on our businesses.

Lazard Ltd is committed to providing timely and accurate information to the investing public, consistent with our legal and regulatory obligations. To that end, Lazard and its operating companies use their websites to convey information about their businesses, including the anticipated release of quarterly financial results, quarterly financial, statistical and business-related information and the posting of updates of assets under management ( AUM ) in various hedge funds and mutual funds and other investment products managed by Lazard Asset Management LLC and its subsidiaries. Monthly updates of these funds will be posted to the Lazard Asset Management website ([www.lazardnet.com](http://www.lazardnet.com)) by the 3rd business day following the end of each month. Investors can link to Lazard and its operating company websites through [www.lazard.com](http://www.lazard.com). Our websites and the information contained therein or connected thereto shall not be deemed to be incorporated into this quarterly report.

### **Completion of Separation and Recapitalization Transactions**

The separation and recapitalization transactions were completed as of May 10, 2005, at which time the separated business became part of LFCM Holdings. Except as otherwise expressly noted, this quarterly report, including this MD&A and the historical consolidated financial data of Lazard Group and Lazard Ltd, reflects the historical results of operations and financial position of Lazard Group and Lazard Ltd, and includes the separated businesses in discontinued operations. In addition to other adjustments, the pro forma financial data included in this Form 10-Q reflects financial data of Lazard Group and Lazard Ltd giving effect to the separation, as well as other adjustments made as a result of the equity public offering, the financing transactions and the recapitalization.

Historical results of operations are reported as a historical partnership until the equity public offering on May 10, 2005 and do not include payments for services rendered by managing directors as compensation expense and a provision for U.S. federal income taxes. Such payments and tax provisions are included in subsequent periods. Therefore, historical results for periods prior to the equity public offering on May 10, 2005 and subsequent thereto are not comparable.

### **Business Summary**

The Company's principal sources of revenue are derived from activities in the following business segments:



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Financial Advisory, which includes providing advice on mergers and acquisitions ( M&A ), restructurings, capital raising and similar transactions, and

Asset Management which includes the management of equity and fixed income securities and merchant banking funds.

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In addition, the Company records selected other activities in Corporate, including cash, certain long-term investments and the commercial banking activities of Lazard Group's Paris-based Lazard Frères Banque SA (LFB). LFB is a registered bank regulated by the Banque de France. LFB's primary commercial banking operations include the management of the treasury positions of the Company's Paris House through its money market desk and, to a lesser extent, credit activities relating to securing loans granted to clients of Lazard Frères Gestion SAS (LFG) and custodial oversight over assets of various clients. In addition, LFB also operates many support functions of the Paris House. The Company also allocates outstanding indebtedness to Corporate. Accordingly, following the equity public offering, the indebtedness and interest expense related to the financing transactions is accounted for as part of Corporate.

Prior to May 10, 2005, the Company also had a business segment called Capital Markets and Other, which consisted of equity, fixed income and convertibles sales and trading, broking, research and underwriting services and merchant banking fund management activities outside of France as well as other specified non-operating assets and liabilities. The Company transferred its Capital Markets and Other segment to LFCM Holdings on May 10, 2005 and it is no longer a segment of the Company. The operating results of the former segment are reflected as discontinued operations.

For the three month and nine month periods ended September 30, 2006 and 2005, the Company's consolidated net revenue was derived from the following business segments:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
Financial Advisory	63%	72%	66%	67%
Asset Management	42	31	37	35
Corporate	(5)	(3)	(3)	(2)
Total	100%	100%	100%	100%

**Business Environment**

Economic and market conditions, particularly global M&A activity, can significantly affect our financial performance. Lazard operates in a very competitive and rapidly changing environment. New risks and uncertainties emerge from time to time, and it is not possible for Lazard's management to predict all risks and uncertainties, nor can Lazard assess the impact of all factors on its business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. See the section entitled "Risk Factors" in the Form 10-K. Net income and revenue in any period may not be indicative of full-year results or the results of any other period and may vary significantly from year to year and quarter to quarter.

**Financial Advisory**

Activity with respect to completed and announced M&A transactions for the industry in the three month and nine month periods ended September 30, 2006 and 2005 are set forth below:

	Three Months Ended			Nine Months Ended		
	September 30,			September 30,		
	2006	2005	Incr/(Decr) %	2006	2005	Incr/(Decr) %
	(\$ in billions)					
<b>Completed M&amp;A Transactions:</b>						
Global	\$ 559	\$ 707	(21)%	\$ 1,876	\$ 1,563	20%
Trans-Atlantic	57	38	50%	166	93	78%

**Announced M&A Transactions:**

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Global	686	616	11%	2,471	1,968	26%
Trans-Atlantic	50	61	(18)%	205	115	78%

*Source: Thomson Financial as of October 23, 2006*

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Lazard believes that its Financial Advisory business should continue to benefit from any sustained increase in M&A volume.

Over the same time frame, financial restructuring activity declined sharply, with the amount of corporate debt defaults, according to Moody's Investors Service, Inc, for the nine month periods ended September 30, 2006 and 2005 at \$4 billion versus \$17 billion, respectively. While the rate of global corporate debt defaults continues to be at near all time low levels, we believe our financial restructuring business should benefit from any future increase in global restructuring activity.

**Asset Management**

For the nine month period ended September 30, 2006, activity in the global stock markets strengthened in both the U.S. and European markets as evidenced by the indices shown on the table below.

Market performance over the twelve month period from October 1, 2005 until September 30, 2006 was also strong across global stock markets, with European and world indices generally growing at a faster rate than U.S. indices.

	Percentage Change September 30, 2006 vs.	
	December 31, 2005	October 1, 2005
MSCI World Index	9%	12%
CAC 40	11%	14%
DAX	11%	19%
FTSE 100	6%	9%
Dow Jones Industrial Average	9%	11%
NASDAQ	2%	5%
S&P 500	7%	9%

The changes in global market indices generally correspond to Lazard's market-related changes in its AUM.

**Key Financial Measures and Indicators****Net Revenue**

The majority of Lazard's Financial Advisory net revenue is earned from the successful completion of mergers, acquisitions, restructurings, capital raising and similar transactions. The main driver of Financial Advisory net revenue is overall M&A and restructuring volume, particularly in the industries and geographic markets in which Lazard focuses. In some client engagements, often those involving financially distressed companies, revenue is earned in the form of retainers and similar fees that are contractually agreed upon with each client for each assignment and are not necessarily linked to the completion of a transaction. In addition, Lazard also earns fees from providing strategic advice to clients, with such fees not being dependent on a specific transaction. Lazard's Financial Advisory segment also earns revenue from public and private securities offerings, including in conjunction with activities of its former Capital Markets and Other segment. In general, fees in conjunction with activities of its former Capital Markets and Other segment are shared equally. As a result of the consummation of the equity public offering, Lazard now has an arrangement with LFCM Holdings under which the separated Capital Markets business will continue to distribute securities in public offerings originated by Lazard's Financial Advisory business in a manner similar to its practice prior to the equity public offering.

Lazard's Asset Management segment includes LAM, LFG and merchant banking operations. Asset Management net revenue is derived from fees for investment management and advisory services provided to institutional and private clients. The main driver of Asset Management net revenue is the level of AUM, which is influenced in large part by Lazard's investment performance and by Lazard's ability to successfully attract and retain assets, as well as the broader performance of the global equity markets and, to a lesser extent, fixed income markets. As a result, fluctuations in financial markets and client asset inflows and outflows have a direct effect on Asset Management net revenue and operating income. In addition, as Lazard's AUM include significant assets that are denominated in currencies other than U.S. dollars, changes in the value of the U.S. dollar relative to



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non-U.S. currencies will impact the value of Lazard's AUM. Fees vary with the type of assets managed, with higher fees earned on actively managed equity assets, alternative investments (such as hedge funds) and merchant banking products, and lower fees earned on fixed income and cash management products. Lazard also earns performance-based incentive fees on some investment products, such as hedge funds, merchant banking funds and other investment products. Incentive fees on hedge funds are typically calculated based on a specified percentage of a fund's net appreciation during a fiscal period and can be subject to loss carry-forward provisions in which losses incurred in the current period are applied against future period net appreciation. Incentive fees on merchant banking funds also may be earned in the form of a carried interest when profits from merchant banking investments exceed a specified threshold. Incentive fees earned for the years ended December 31, 2005, 2004, and 2003 of \$45 million, \$27 million and \$38 million, respectively, demonstrate the volatility incentive fees may have on total net revenue.

Corporate net revenue consists primarily of investment income generated from long-term investments, including principal investments that Lazard has made in merchant banking and alternative investment funds managed by the Asset Management segment, net interest income generated by LFB, interest income related to cash and interest expense related to outstanding borrowings. As a result of the consummation of the equity public offering, interest expense related to the financing transactions is included in Corporate net revenue. Corporate net revenue can fluctuate due to mark-to-market adjustments on long-term investments, changes in interest rates and in interest rate spreads earned by LFB and changes in the levels of Lazard's cash, long-term investments and indebtedness. In addition, during the nine month period ended September 30, 2006, Corporate net revenue includes a gain of approximately \$14 million, excluding transaction and other costs, relating to the termination of the Intesa joint venture (with such gain, after transaction and other costs, increasing operating income by approximately \$5 million). Although Corporate net revenue during the nine month period ended September 30, 2006 represented (3)% of Lazard's net revenue, total assets in this segment represented 66% of Lazard's consolidated total assets as of September 30, 2006, principally attributable to the relatively significant amounts of assets associated with LFB, and, to a lesser extent, cash and long-term investment balances.

Lazard expects to experience significant fluctuations in net revenue and operating income during the course of any given year. These fluctuations arise because a significant portion of Financial Advisory net revenue is earned upon the successful completion of a transaction, financial restructuring or capital raising activity, the timing of which is uncertain and is not subject to Lazard's control. Asset Management net revenue is also subject to periodic fluctuations. Asset Management fees are generally based on AUM measured as of the end of a quarter or month, and an increase or reduction in AUM at such dates, due to market price fluctuations, currency fluctuations, net client asset flows or otherwise, will result in a corresponding increase or decrease in management fees. In addition, incentive fees earned on AUM are generally not recorded until potential uncertainties regarding the ultimate realizable amounts have been determined. For most of our funds such date is year-end, and therefore such incentive fees are recorded in the fourth quarter of Lazard's fiscal year.

***Operating Expenses***

The majority of Lazard's operating expenses relate to compensation and benefits. As a limited liability company, prior to the consummation of the equity public offering on May 10, 2005 payments for services rendered by the majority of Lazard's managing directors were accounted for as distributions of members' capital. In addition, subsequent to January 1, 2003, payments for services rendered by managing directors of LAM (and employee members of LAM) were accounted for as minority interest in net income. See *Minority Interest*. Subsequent to the consummation of the equity public offering, Lazard now includes all payments for services rendered by its managing directors, including the managing directors of LAM and distributions to profit participation members, in compensation and benefits expense. As a result, while Lazard's compensation and benefits expense and operating income for the nine month period ended September 30, 2006 includes all such payments, compensation and benefits expense and operating income for the nine month period ended September 30, 2005 did not include those payments for services rendered by Lazard's managing directors prior to May 10, 2005.

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The balance of Lazard's operating expenses is referred to below as non-compensation expense, which includes costs for premises and occupancy, professional fees, travel and entertainment, communications and information services, equipment, depreciation and amortization and other expenses.

The operating expenses set forth in Consolidated Results of Operations includes the added costs Lazard incurred as a result of the equity public offering after May 10, 2005. Lazard has incurred additional expenses for, among other things, directors' fees, SEC reporting and compliance, insurance, investor relations, legal, accounting and other costs associated with being a public company.

### ***Provision for Income Taxes***

Lazard has historically operated in the U.S. as a limited liability company that was treated as a partnership for U.S. federal income tax purposes. As a result, Lazard has not been subject to U.S. federal income taxes. Taxes related to income earned by partnerships represent obligations of the individual partners. Outside the U.S., Lazard historically has operated principally through corporations and has been subject to local income taxes. Income taxes shown on Lazard's consolidated statement of income for the three and nine month periods ended September 30, 2005 include taxes incurred in non-U.S. entities and UBT attributable to Lazard's operations apportioned to New York City prior to May 10, 2005.

Following the equity public offering, Lazard Group is continuing to operate in the U.S. as a limited liability company treated as a partnership for U.S. federal income tax purposes and remains subject to local income taxes outside the U.S. and to UBT. In addition, Lazard Ltd's corporate subsidiaries are subject to additional income taxes, which taxes are reflected in its unaudited condensed consolidated statements of income for the three month and nine month periods ended September 30, 2006 and, with respect to the three month and nine month periods ended September 30, 2005, for the period May 10, 2005 through September 30, 2005.

### ***Minority Interest***

Minority interest consists of a number of components. As described below, amounts recorded as minority interest for the three month and nine month periods ended September 30, 2006 are not comparable to amounts recorded as minority interest for the three month and nine month periods ended September 30, 2005.

Commencing May 10, 2005, the Company has recorded a charge to minority interest in net income relating to LAZ-MD Holdings' ownership interest in Lazard Group (which approximated 62.3% at September 30, 2006), with such expense amounting to \$25.3 million and \$107.6 million for the three month and nine month periods ended September 30, 2006, respectively, versus \$36.4 million and \$59.2 million for the three month and nine month periods ended September 30, 2005, respectively (which represented LAZ-MD Holdings' ownership interest in Lazard Group for the period May 10, 2005 through September 30, 2005).

The Company consolidates various LAM related general partnership interests that it controls but does not wholly own, and its business in Italy which was 40% owned by Banca Intesa S.p.A (Intesa) until May 15, 2006.

As described in Note 5 of Notes to Unaudited Condensed Consolidated Financial Statements, on May 15, 2006 Lazard Group, Lazard & Co. S.r.l. (Lazard Italy), an indirect subsidiary of Lazard Group, and Intesa completed the termination of their joint venture relationship in Italy. Accordingly, as a result of the termination, Lazard Group now owns 100% of Lazard Italy, and therefore minority interest excludes Intesa's formerly owned interest in Lazard Italy.

As described in Note 1 of Notes to Unaudited Condensed Consolidated Financial Statements, commencing May 10, 2005, the Company no longer recognizes payments for services rendered by the managing directors of LAM (and employee members of LAM) as charges to minority interest. Effective May 10, 2005, those charges are now included in compensation and benefits expense and distributions to profit participation members.

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### ***Discontinued Operations***

As described above, in connection with the separation Lazard Group transferred the Capital Markets and Other segment to LFCM Holdings as of May 10, 2005. Capital Markets and Other net revenue largely consisted of primary revenue earned from underwriting fees from securities offerings and secondary revenue earned in the form of commissions and trading profits from principal transactions in Lazard Group's equity, fixed income and convertibles businesses and underwriting and other fee revenue from corporate broking in the U.K. Lazard Group also earned fund management fees and, if applicable, carried interest incentive fees related to merchant banking funds managed as part of this former segment. Such carried interest incentive fees were earned when profits from merchant banking investments exceeded a specified threshold. In addition, this former segment generated investment income and net interest income principally from long-term investments, cash balances and securities financing transactions.

### ***Net Income (Net Income Allocable to Members of Lazard Group Prior to May 10, 2005)***

Prior to the equity public offering, payments for services rendered by Lazard Group's managing directors were accounted for as distributions from members' capital, or as minority interest in net income in the case of payments to LAM managing directors and certain key LAM employee members, rather than as compensation and benefits expense. As a result, prior to May 10, 2005 Lazard Group's compensation and benefits expense and net income allocable to members, did not reflect most payments for services rendered by its managing directors. Following the consummation of the equity public offering and financing transactions, the Company now includes all payments for services rendered by its managing directors, including the managing directors of LAM and distributions to profit participation members, in compensation and benefits expense.

### **Consolidated Results of Operations**

Lazard's consolidated financial statements are presented in U.S. dollars. Many of our non-U.S. subsidiaries have a functional currency (*i.e.*, the currency in which operational activities are primarily conducted) that is other than the U.S. dollar, generally the currency of the country in which the subsidiaries are domiciled. Such subsidiaries' assets and liabilities are translated into U.S. dollars using exchange rates as of the respective balance sheet date while revenue and expenses are translated at average exchange rates during the respective periods. Adjustments that result from translating amounts from a subsidiary's functional currency are reported as a component of stockholders' equity. Foreign currency remeasurement gains and losses on transactions in non-functional currencies are included in the condensed consolidated statements of income.

Historical results of operations are reported as an historical partnership until the equity public offering on May 10, 2005 and do not include payments for services rendered by managing directors as compensation expense and a provision for U.S. federal income taxes. Such payments and tax provisions are included in subsequent periods. Therefore, historical results for periods prior to the equity public offering on May 10, 2005 and subsequent thereto are not comparable.



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A discussion of the Company's consolidated results of operations for the three month and nine month periods ended September 30, 2006 and 2005, is set forth below, followed by a more detailed discussion of business segment results.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
	(\$ in thousands)			
<b>Revenue</b>				
Investment banking and other advisory fees	\$ 183,318	\$ 251,663	\$ 655,704	\$ 615,361
Money management fees	116,113	101,282	346,584	302,507
Commissions	3,195	3,569	12,474	11,354
Underwriting	2,487	4,626	12,912	10,155
Investment gains and losses - net	4,448	4,944	13,673	8,446
Interest income	11,755	10,210	29,593	24,260
Other	2,706	5,207	26,631	15,823
<b>Total revenue</b>	<b>324,022</b>	<b>381,501</b>	<b>1,097,571</b>	<b>987,906</b>
Interest expense	26,510	24,598	76,893	53,541
<b>Net revenue</b>	<b>297,512</b>	<b>356,903</b>	<b>1,020,678</b>	<b>934,365</b>
<b>Operating Expenses</b>				
Compensation and benefits (and, commencing May 10, 2005, distributions to profit participation members)(*)	180,982	215,199	615,269	482,228
Non-compensation expense	67,337	64,415	193,407	186,859
<b>Total operating expenses</b>	<b>248,319</b>	<b>279,614</b>	<b>808,676</b>	<b>669,087</b>
<b>Operating Income from Continuing Operations(*)</b>	<b>49,193</b>	<b>77,289</b>	<b>212,002</b>	<b>265,278</b>
Provision for income taxes(*)	10,153	17,177	44,827	50,443
<b>Income from Continuing Operations Before Minority Interest in Net Income(*)</b>	<b>39,040</b>	<b>60,112</b>	<b>167,175</b>	<b>214,835</b>
Minority interest in net income	25,882	41,101	110,786	77,707
<b>Income from Continuing Operations(*)</b>	<b>13,158</b>	<b>19,011</b>	<b>56,389</b>	<b>137,128</b>
<b>Loss from Discontinued Operations(*) (net of income tax provision of \$253 and \$3,330 for the three month and nine month periods ended September 30, 2005, respectively)</b>		<b>(408)</b>		<b>(17,576)</b>
<b>Net Income (Net Income Allocable to Members of Lazard Group for Periods Prior to May 10, 2005)(*)</b>	<b>\$ 13,158</b>	<b>\$ 18,603</b>	<b>\$ 56,389</b>	<b>\$ 119,552</b>

(\*) Excludes, as applicable, with respect to the periods prior to May 10, 2005 (a) payments for services rendered by Lazard Group's managing directors, which, as a result of Lazard Group operating as a limited liability company, historically had been accounted for as distributions from members' capital, or in some cases as minority interest, rather than as compensation and benefits expense, and (b) U.S. corporate federal income taxes, since Lazard Group has operated in the U.S. as a limited liability company that was treated as a partnership for U.S. federal income tax purposes.

The Company calculates operating revenue for the three month and nine month periods ended September 30, 2006 and 2005 as follows:

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	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
	(\$ in thousands)			
Historical total revenue	\$324,022	\$381,501	\$1,097,571	\$987,906
Deduct:				
LFB interest expense	(5,817)	(4,489)	(14,866)	(15,234)
Revenue related to consolidation of LAM general partnerships	(600)	(2,752)	(3,137)	(2,752)
Operating revenue	\$317,605	\$374,260	\$1,079,568	\$969,920

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Certain ratios and headcount information for the three month and nine month periods ended September 30, 2006 and 2005 are set forth below:

	Three Months Ended		Nine Months Ended	
	September 30, 2006	2005	September 30, 2006	2005
<b>As a % of Net Revenue, By Revenue Category:</b>				
Investment banking and other advisory fees	62%	71%	64%	66%
Money management fees	39	28	34	32
Commissions	1	1	1	1
Underwriting	1	1	1	1
Investment gains and losses net	1	1	1	1
Interest income	4	3	3	3
Other	1	2	3	2
Interest expense	(9)	(7)	(7)	(6)
Net revenue	100%	100%	100%	100%
<b>As a % of Net Revenue:</b>				
Operating Income	17%	22%	21%	28%

	As of September 30,	
	2006	2005
<b>Headcount:</b>		
Managing Directors:		
Financial Advisory	125	123
Asset Management	43	38
Corporate	8	8
Limited Managing Directors	5	16
Other Employees:		
Business segment professionals	794	769
All other professionals and support staff	1,197	1,244
Total	2,172	2,198

**Revenue and Operating Expenses**

*Three Months Ended September 30, 2006 versus September 30, 2005*

Net revenue was \$298 million for the three month period ended September 30, 2006, a decrease of \$59 million, or 17%, versus net revenue of \$357 million in the corresponding period in 2005. During the 2006 period, fees from investment banking and other advisory activities were \$183 million, a decrease of \$69 million or 27% versus fees of \$252 million in the corresponding period in 2005. The decrease is due primarily to three factors: the number of M&A transactions closing in the third quarter of 2006; the relatively high number of transactions closing in the second quarter of 2006; and comparison with the unusually high 2005 third-quarter revenue, due particularly to our Financial Restructuring and Private Fund Advisory Group activities. Money management fees were \$116 million, an increase of \$15 million, or 15%, versus \$101 million in the corresponding period in 2005. The increase in money management fees was principally the result of a \$11.8 billion, or 14% increase in average AUM for the three month period ended September 30, 2006 as compared to the three month period ended September 30, 2005, and, to a lesser extent, an increase in incentive fees recorded in the 2006 period. Underwriting revenue, including referral fees from LFCM, of \$2.5 million decreased by \$2.1 million, or 46%, versus \$4.6 million in the corresponding period in 2005 due to lower underwriting activity in the 2006 period. Other revenue of \$2.7 million decreased by \$2.5 million, or 48%, versus \$5.2 million in the corresponding period.



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in 2005 principally due to foreign exchange losses resulting from the revaluation of certain assets and liabilities. Interest expense of \$27 million increased by \$2 million primarily from the commercial banking activities in LFB.

Compensation and benefits expense was \$181 million for the three month period ended September 30, 2006, a decrease of \$34 million, or 16%, versus expense of \$215 million in the corresponding period in 2005. The decrease was primarily due to lower accruals for performance-based bonus awards consistent with the decrease in operating revenues. Headcount (including managing directors and all other employees) as of September 30, 2006 was 2,172, down 26 versus headcount as of September 30, 2005, representing reductions principally in support personnel, partially offset by increases in Asset Management headcount as a result of hirings in selected areas.

Non-compensation expense was \$67 million or 21% of operating revenue of \$318 million in the three month period ended September 30, 2006, compared with \$64 million or 17% of operating revenue of \$374 million for the corresponding period in 2005. The increase in the ratio reflects reduced operating revenues and an \$8 million increase in professional fees versus the comparable period in 2005, partially offset by a decrease in all other non-compensation expenses by an aggregate of \$5 million versus the 2005 period. The increase in professional fees was principally due to higher legal fees, fees for outsourced services, as well as consulting fees related to the Company's activities to comply with the Sarbanes-Oxley Act of 2002. The decrease in all other non-compensation expenses was principally due to declines in unrecovered VAT expense, and various other miscellaneous expenses.

Operating income, was \$49 million for the three month period ended September 30, 2006, a decrease of \$28 million, or 36% lower than operating income of \$77 million for the corresponding period in 2005. Operating income as a percentage of net revenue was 17% for the third quarter of 2006 versus 22% for the corresponding period in 2005, with the decrease in operating income and the relative margin primarily resulting from the decrease in revenue. Our quarterly revenue and profits can fluctuate materially depending on the number, size and timing of completed transactions on which we advise, as well as seasonality and other factors.

## **Revenue and Operating Expenses**

### *Nine Months Ended September 30, 2006 versus September 30, 2005*

Net revenue was \$1,021 million for the nine month period ended September 30, 2006, up \$86 million, or 9%, versus net revenue of \$934 million in the corresponding period in 2005. During the 2006 period, fees from investment banking and other advisory activities were \$656 million, an increase of \$40 million, or 7%, versus fees of \$615 million in the corresponding period in 2005, a result of strong M&A performance in the first half of 2006. Money management fees were \$347 million, an increase of \$44 million, or 15%, versus \$303 million in the corresponding period in 2005. The increase in money management fees was principally the result of a \$8.6 billion, or 10%, increase in average AUM for the nine month period ended September 30, 2006 as compared to the nine month period ended September 30, 2005, as well as an increase in incentive fees recorded in the 2006 period. Underwriting, including referral fees from LFCM, of \$13 million increased by \$3 million or 27% versus the corresponding period in 2005 principally due to an increase in underwriting activity in the 2006 period. Net investment gains of \$14 million increased by \$5 million, or 62%, primarily related to higher dividend income in the 2006 period as well as certain losses incurred in the 2005 period which did not recur in 2006. Interest Income of \$30 million increased \$5 million, or 22%, principally due to average higher cash balances throughout the 2006 period. Other revenue of \$27 million increased by \$11 million, or 68%, versus the corresponding period in 2005 principally due to the impact of a gain of approximately \$14 million (excluding transaction and other costs) recognized on the termination of the Intesa joint venture (see [Liquidity and Capital Resources](#) below). Interest expense of \$77 million increased by \$23 million due to the incremental interest expense on financings primarily related to the issuance of debt and equity security units that occurred on May 10, 2005 in connection with the equity public offering and recapitalization, with such debt and equity security units outstanding for the full period in 2006 as compared to only part of the 2005 period.

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Compensation and benefits expense was \$615 million for the nine month period ended September 30, 2006, an increase of \$133 million, or 28%, versus expense of \$482 million in the corresponding period in 2005. The increase was due to higher accruals for performance-based bonus awards consistent with the increase in operating revenues as well as the Company's inclusion, for the period subsequent to the consummation of the equity public offering, of all payments for services rendered by our managing directors in compensation and benefits expense, including distributions to profit participation members and payments for services rendered by managing directors of LAM (and employee members of LAM), the latter of which previously had been accounted for as minority interest in net income.

Non-compensation expense was \$193 million, or 18% of operating revenue of \$1,080 million in the nine month period ended September 30, 2006, compared with \$187 million, or 19% of operating revenue of \$970 million for the corresponding period in 2005. The decrease in the year-to-date ratio is due to the operating leverage from higher operating revenues. For the nine month period ended September 30, 2006, professional fees increased approximately \$20 million versus the 2005 period, partially offset by a decrease in all other non-compensation expenses by an aggregate of \$13 million versus the 2005 period. The increase in professional fees was due to consulting and audit fees related to the Company's activities to comply with the Sarbanes-Oxley Act of 2002, various legal fees, recording of a commitment to a former managing director, and increased fees relating to outsourced services. The decrease in other non-compensation expenses primarily reflects the recovery of VAT costs expensed in prior years, and declines in unrecoverable deal-related expenses and insurance expense.

Operating income, including the one-time gain on termination of the Intesa joint venture as described above, which, after transaction and other costs, served to increase operating income by approximately \$5 million, was \$212 million for the nine month period ended September 30, 2006, a decrease of \$53 million, or 20% lower than operating income of \$265 million for the corresponding period in 2005. Operating income as a percentage of net revenue was 21% for the first nine months of 2006 versus 28% for the corresponding period in 2005, with the decrease in operating income and the relative margin primarily resulting from the increase in compensation and benefits expense described above partially offset by the increase in revenues. As stated above, historical results for periods prior to the equity public offering on May 10, 2005 and subsequent thereto are not comparable.

### **Income Taxes**

For the three month period ended September 30, 2006, the provision for income taxes was \$10 million, a decrease of approximately \$7 million versus \$17 million for the corresponding period in 2005. For the nine month period ended September 30, 2006, the provision for income taxes was \$45 million, a decrease of approximately \$6 million versus \$51 million for the corresponding period in 2005. The decrease in both the three and nine month periods of 2006 was principally due to decreased tax provisions recorded for those locations that are subject to corporate income taxes and, in the nine month period ended September 30, 2006, partially offset by additional entity level income taxes incurred in Lazard Ltd. Such additional entity level taxes were incurred for the full period in 2006 as compared to only part of the 2005 period.

### **Minority Interest In Net Income**

For the three month period ended September 30, 2006, minority interest in net income was \$26 million, a decrease of \$15 million versus \$41 million for the 2005 period. For the nine month period ended September 30, 2006, minority interest was \$111 million, an increase of \$33 million versus \$78 million for the corresponding period in 2005. The decrease in the three month period ended September 30, 2006 was due to a reduction in income from continuing operations. The increase in the nine month period ended September 30, 2006 was principally due to the minority interest in net income related to LAZ-MD Holdings' ownership interest (62.3% as of September 30, 2006) of Lazard Group, commencing May 10, 2005. This increase was partially offset by there being no expense relating to the minority interest in net income associated with the Intesa joint venture in the three month and nine month periods ended September 30, 2006 as well as compensation for LAM members now being recorded in compensation and benefits expense commencing with the consummation of the equity public

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offering on May 10, 2005, while, prior thereto, such amounts were recorded in minority interest in net income. In addition, minority interest also includes an approximate \$0.6 million and a \$3 million expense recorded for the three and nine month periods ended September 30, 2006, respectively, representing the elimination of revenue from LAM general partnerships held directly by certain of our LAM managing directors, versus \$2.8 million recorded for both the three and nine month periods ended September 30, 2005. As described above, amounts recorded as minority interest in net income for periods prior to May 10, 2005 are not comparable to amounts recorded as minority interest in net income for periods commencing May 10, 2005.

## **Discontinued Operations**

The Company had no income from discontinued operations during the three month and nine month periods ended September 30, 2006, versus losses from discontinued operations of \$0.4 million and \$17.6 million, respectively, for the corresponding periods in 2005.

## **Business Segments**

The following data discusses net revenue and operating income for the Company's continuing operations by business segment. The operating results exclude a discussion of Corporate, which, apart from interest expense, contributes a relatively minor amount to operating income. Each segment's operating expenses include (i) compensation and benefits expenses that are incurred directly in support of the businesses and (ii) other operating expenses, which include directly incurred expenses for premises and occupancy, professional fees, travel and entertainment, communications and information services, equipment, and indirect support costs (including compensation and benefits expense and other operating expenses related thereto) for administrative services. Such administrative services include, but are not limited to, accounting, tax, legal, facilities management and senior management activities. Such support costs are allocated to the relevant segments based on various statistical drivers such as, among other items, headcount, square footage and transactional volume.

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The following table summarizes the operating results of the Financial Advisory segment.

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
	(\$ in thousands)			
M&A	\$ 153,215	\$ 187,241	\$ 545,054	\$ 491,559
Financial Restructuring	15,562	39,956	50,202	80,367
Corporate Finance and Other	18,273	30,588	75,989	54,684
Net Revenue	187,050	257,785	671,245	626,610
Direct Compensation and Benefits and, commencing May 10, 2005, distributions to profit participation members	94,615	130,476	360,983	269,388
Other Operating Expenses(a)	48,081	44,278	137,636	143,251
Total Operating Expenses	142,696	174,754	498,619	412,639
Operating Income	\$ 44,354	\$ 83,031	\$ 172,626	\$ 213,971
Operating Income as a Percentage of Net Revenue	24%	32%	26%	34%

	As of September 30,	
	2006	2005
Headcount (b):		
Managing Directors	125	123
Limited Managing Directors	2	5
Other Employees:		
Business segment professionals	501	488
All other professionals and support staff	246	259
Total	874	875

(a) Includes indirect support costs (including compensation and benefits expense and other operating expenses related thereto).

(b) Excludes headcount related to indirect support functions. Such headcount is included in the Corporate headcount.



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Net revenue trends in Financial Advisory for M&A and Financial Restructuring generally are correlated to the volume of completed industry-wide mergers and acquisitions activity and restructurings occurring subsequent to corporate debt defaults, respectively. However, deviations from this relationship can occur in any given year for a number of reasons. For instance, material variances in the level of mergers and acquisitions activity in a particular geography where Lazard has significant market share or the number of its advisory engagements with respect to larger-sized transactions can cause its results to diverge from industry-wide activity. Certain Lazard client statistics are set forth below:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
<b>Lazard Statistics:</b>				
Number of Clients:				
Total	120	135	377	371
With Fees Greater than \$1 million	41	52	144	130
Percentage of Total Fees from Top 10 Clients	48%	41%	25%	24%
Number of M&A Transactions Completed Greater than \$1 billion	6	17	33	33

The geographical distribution of Financial Advisory net revenue is set forth below in percentage terms. The offices that generate Financial Advisory net revenue are located in North America, Europe (principally in the U.K., France, Italy, Spain and Germany) and the rest of the world (principally in Asia).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
North America	41%	51%	54%	44%
Europe	58	48	44	54
Rest of World	1	1	2	2
Total	100%	100%	100%	100%

The Company's managing directors and many of its professionals have significant experience, and many of them are able to use this experience to advise on both mergers and acquisitions and financial restructuring transactions, depending on clients' needs. This flexibility allows Lazard to better match its professional staff with the counter-cyclical business cycles of mergers and acquisitions and financial restructurings. While Lazard measures revenue by practice area, Lazard does not separately measure the separate costs or profitability of mergers and acquisitions services as compared to financial restructuring services. Accordingly, Lazard measures performance in its Financial Advisory segment based on overall segment net revenue and operating income margins.

**Financial Advisory Results of Operations***Three Months Ended September 30, 2006 versus September 30, 2005*

In the 2006 period, Financial Advisory net revenue was \$187 million, a decrease of \$71 million, or 27%, versus net revenue of \$258 million in the corresponding period in 2005. M&A net revenue of \$153 million decreased \$34 million, or 18%, versus the corresponding period in 2005. In addition, Financial Restructuring net revenue declined by \$24 million, or 61%, versus the corresponding period in 2005. Corporate Finance and Other net revenue of \$18 million decreased by approximately \$12 million, or 40%, versus net revenue of \$30 million in the 2005 period.

The decrease in M&A net revenue is due primarily to three factors: the number of M&A transactions closing in the third quarter of 2006; the relatively high number of transactions closing in the second quarter of 2006; and comparison with the unusually high 2005 third-quarter revenue. The third quarter of 2005 was both a record third

quarter and the strongest quarter in 2005. Transactions completed in the third quarter of 2006 on which Lazard's M&A Group advised included Resolution plc's £3.6 billion acquisition of Abbey National plc's Life businesses,



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International Paper's \$1.4 billion sale of its coated and super calendared papers business to CMP Holdings LLC, an affiliate of Apollo Management L.P., Uniland's 1.1 billion sale to Cementos Portland Valderrivas, Camfin's 1.0 billion joint venture with Gaz de France for the sale of natural gas in Italy, and Iberostar Hoteles' 884 million sale to Carlyle. Other clients with whom we transacted significant business during the third quarter of 2006 included Bridgepoint Capital, KeySpan Corporation, The McKenzie River Corporation, Muehlstein, Paroc, Permira and Saint-Gobain. Among the pending M&A transactions announced on which Lazard is advising are Gaz de France's 37.8 billion merger with Suez, Abertis Infraestructuras' 22.9 billion merger of equals with Autostrade, Pfizer's \$16.6 billion sale of its Consumer Healthcare business to Johnson & Johnson, Cerberus' \$14.0 billion consortium acquisition of a controlling stake in GMAC, Fisher Scientific's \$12.8 billion merger with Thermo Electron, KeySpan's \$11.8 billion sale to National Grid, Chicago Board of Trade's (advisors to Special Transaction Committee) \$8.0 billion merger with the Chicago Mercantile Exchange, International Paper's \$6.1 billion sale of 5.1 million acres of U.S. forestlands, Schneider Electric's \$6.1 billion acquisition of American Power Conversion, and UCB's 4.4 billion acquisition of Schwarz Pharma.

Financial Restructuring net revenue decreased as compared to the three month period ended September 30, 2005, principally due to the low level of debt defaults experienced in the last twelve months. Recently completed Restructuring assignments include Armstrong Holdings. Notable Restructuring assignments announced since the second quarter include our retention to advise Radnor Holdings in connection with its Chapter 11 filing. Additionally, we are continuing our work on a number of other Restructuring assignments, including those involving Adelphia, Collins & Aikman, Eurotunnel, Meridian Automotive, Olympic Airlines, Owens-Corning, SunCom Wireless and Tower Automotive. Additionally, we continue to advise Calpine's Unsecured Creditors Committee, Northwest Airlines Creditors Committee and the UAW in connection with Delphi's bankruptcy and with regard to alternatives for restructuring Chrysler's post-retirement healthcare obligations.

Corporate Finance net revenues in the 2006 period also declined principally in our private equity fund raising group, which advised on a number of large fund closings in the third quarter of 2005.

Operating expenses were \$143 million in the 2006 period, a decrease of approximately \$32 million, or 18%, versus operating expenses of \$175 million in the corresponding period in 2005. Compensation and benefits expense decreased by \$36 million, or 27%, as compared to the corresponding period in 2005, primarily reflecting a decrease in accruals for performance-based bonus awards consistent with the decrease in operating revenues. All other operating expenses increased by \$4 million, or 9%, principally due to increased support costs.

Financial Advisory operating income was \$44 million for the 2006 period, a decrease of \$39 million, or 47%, versus operating income of \$83 million in the corresponding period in 2005. Operating income as a percentage of segment net revenue was 24% for the 2006 period versus 32% in the corresponding period in 2005, with the decrease in operating income and relative margin principally the result of lower revenues. Our quarterly revenue and profits can fluctuate materially depending on the number, size and timing of completed transactions on which we advise, as well as seasonality and other factors.

*Nine Months Ended September 30, 2006 versus September 30, 2005*

In the 2006 period, Financial Advisory net revenue was \$671 million, an increase of \$45 million, or 7%, versus net revenue of \$627 million in the corresponding period in 2005. M&A net revenue of \$545 million increased \$53 million, or 11%, versus the corresponding period in 2005, driven by the environment for mergers and acquisitions activity and by improved productivity of our managing directors. The increase in M&A net revenue was partially offset by a \$30 million, or 38%, decrease in Financial Restructuring net revenue versus the corresponding period in 2005. Corporate Finance and Other net revenue increased by approximately \$21 million, or 39%, principally as a result of a higher level of private equity fund raising.

Operating expenses were \$499 million in 2006 period, an increase of \$86 million, or 21%, versus operating expenses of \$413 million in the corresponding period in 2005. Compensation and benefits expense increased by \$92 million, or 34%, as compared to the corresponding period in 2005. The increase was principally due to the inclusion, for the period subsequent to the consummation of the equity public offering, of all payments for

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services rendered by our managing directors, including distributions to profit participation members, in compensation and benefits expense. In addition, accruals for performance-based bonus awards increased in the 2006 period consistent with the increase in operating revenues. Other operating expenses decreased by \$6 million, or 4%, principally due to the recovery of VAT costs expensed in prior years, and declines in premises costs, and unrecoverable deal-related expenses.

Financial Advisory operating income was \$173 million for the 2006 period, \$41 million lower than the corresponding period in 2005. Operating income as a percentage of segment net revenue was 26% for 2006 versus 34% in the corresponding period in 2005, with the increase in recorded compensation expense in the 2006 period being partially offset by the leverage resulting from higher revenues. As stated above, historical results for periods prior to the equity public offering on May 10, 2005 and subsequent thereto are not comparable.

**Asset Management**

The following table shows the composition of AUM for the Asset Management segment:

	September 30, 2006	As of December 31, 2005
	(\$ in millions)	
<b>AUM:</b>		
International Equities	\$ 47,122	\$ 42,104
Global Equities	21,995	15,872
U.S. Equities	12,669	12,920
<b>Total Equities</b>	<b>81,786</b>	<b>70,896</b>
International Fixed Income	7,685	6,604
Global Fixed Income	1,006	2,135
U.S. Fixed Income	2,422	2,374
<b>Total Fixed Income</b>	<b>11,113</b>	<b>11,113</b>
Alternative Investments	3,653	3,394
Merchant Banking	854	826
Cash Management	1,928	2,005
<b>Total AUM</b>	<b>\$ 99,334</b>	<b>\$ 88,234</b>

Average AUM for the three month and nine month periods ended September 30, 2006 and 2005, is set forth below. Average AUM is based on an average of quarterly ending balances for the respective periods.

	Three Months Ended September 30, 2006	2005	Nine Months Ended September 30, 2006	2005
	(\$ in millions)			
Average AUM	\$ 96,618	\$ 84,802	\$ 94,151	\$ 85,574

The following is a summary of changes in AUM for the three month and nine month periods ended September 30, 2006 and 2005.

Three Months Ended September 30,	Nine Months Ended September 30,
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	2006	2005	2006	2005
	(\$ in millions)			
AUM Beginning of Period	\$ 93,901	\$ 83,012	\$ 88,234	\$ 86,435
Net Flows	1,693	(1,751)	983	(4,349)
Market Appreciation	3,792	5,369	9,337	5,654
Foreign Currency Adjustments	(52)	(38)	780	(1,148)
AUM End of Period	\$ 99,334	\$ 86,592	\$ 99,334	\$ 86,592

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AUM as of September 30, 2006 was \$99.3 billion, up \$11.1 billion from AUM of \$88.2 billion as of December 31, 2005. Merchant banking AUM as of September 30, 2006 and December 31, 2005 includes approximately \$0.5 billion and \$0.4 billion, respectively, of assets held by an investment company for which Lazard may earn carried interests. During the nine month period ended September 30, 2006, market appreciation of \$9.3 billion was accompanied by net inflows of \$1.0 billion and the positive impact of changes in foreign currency exchange rates of approximately \$0.8 billion. Net inflows were experienced in Emerging Markets, Global Thematic Equity, U.K. and European Equity products partially offset by outflows in International Equity products.

For the three month period ended September 30, 2006, average AUM was \$96.6 billion, an increase of \$11.8 billion, or 14%, versus \$84.8 billion in the corresponding period in 2005. For the nine month period ended September 30, 2006, average AUM was \$94.2 billion, an increase of \$8.6 billion, or 10%, versus \$85.6 billion in the corresponding period in 2005.

The following table summarizes the operating results of the Asset Management segment.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
	(\$ in thousands)			
Management Fees	\$ 112,726	\$ 98,269	\$ 328,734	\$ 291,047
Incentive Fees	3,423	2,717	17,362	10,650
Other	8,639	7,256	27,559	22,246
Sub-Total	124,788	108,242	373,655	323,943
LAM GP-Related Revenue	600	2,752	3,137	2,752
Net Revenue	125,388	110,994	376,792	326,695
Direct Compensation and Benefits, and, commencing May 10, 2005, distributions to profit participation members	60,708	55,225	173,698	133,438
Other Operating Expenses(a)	42,372	35,710	120,814	111,532
Total Operating Expenses	103,080	90,935	294,512	244,970
Operating Income	\$ 22,308	\$ 20,059	\$ 82,280	\$ 81,725
Operating Income as a Percentage of Net Revenue	18%	18%	22%	25%

	As of September 30,	
	2006	2005
Headcount(b):		
Managing Directors	43	38
Limited Managing Directors	2	2
Other Employees:		
Business segment professionals	285	270
All other professionals and support staff	326	321
Total	656	631

(a) Includes indirect support costs (including compensation and benefits expense and other operating expenses related thereto).

(b) Excludes headcount related to indirect support functions. Such headcount is included in the Corporate headcount.



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The geographical distribution of Asset Management net revenue is set forth below in percentage terms:

	Three Months		Nine Months	
	Ended September 30, 2006	2005	Ended September 30, 2006	2005
North America	55%	59%	56%	58%
Europe	37	34	36	34
Rest of World	8	7	8	8
Total	100%	100%	100%	100%

**Asset Management Results of Operations***Three Months Ended September 30, 2006 versus September 30, 2005*

Asset Management net revenue was \$125 million for the 2006 period, an increase of \$14 million, or 13%, versus net revenue of approximately \$111 million for the corresponding period in 2005. Management fees for the 2006 period were \$113 million, up \$14 million, or 15%, slightly higher than the increase in average AUM for the corresponding period in 2005 principally due to a shift in AUM to higher fee based products. Incentive fees earned for the 2006 period were \$3.4 million, an increase of \$0.7 million versus \$2.7 million recorded for the corresponding period in 2005 due to better performance in certain funds that provide for such incentive fees with a measurement date in the respective three month periods. Other income was \$9 million, an increase of \$1 million. In addition, during the three month period ended September 30, 2006, revenue of \$0.6 million from LAM general partnerships held directly by certain of our LAM managing directors was recorded, versus \$2.8 million in the corresponding period in 2005, with these amounts being also added as minority interest in net income.

Operating expenses were \$103 million for the 2006 period, an increase of \$12 million, or 13%, versus operating expenses of \$91 million for the corresponding period in 2005. Compensation and benefits expense increased by \$5 million, or 10%, as compared to the corresponding period in 2005. The increase was principally due to higher performance-based bonus awards, consistent with the increase in operating revenues. All other operating expenses increased by \$7 million versus the corresponding period in 2005 principally due to increased professional fees for outsourced services, legal fees as well as higher support costs.

Asset Management operating income was \$22 million for 2006 period, an increase of \$2 million, or 11%, versus operating income of \$20 million for the corresponding period in 2005. Operating income as a percentage of segment net revenue was 18% for the 2006 period, flat versus the corresponding period in 2005.

*Nine Months Ended September 30, 2006 versus September 30, 2005*

Asset Management net revenue was \$377 million for the 2006 period, an increase of \$50 million, or 15%, versus net revenue of approximately \$327 million for the corresponding period in 2005. Management fees for the 2006 period were \$329 million, up \$38 million, or 13%, slightly higher than the increase in average AUM for the corresponding period in 2005 principally due to a shift in AUM to higher fee based products. Incentive fees earned for the 2006 period were \$17 million, an increase of \$7 million versus approximately \$10 million recorded for the corresponding period in 2005 due to better performance in certain funds that provide for such incentive fees with a measurement date in the respective nine month periods. Other income was \$28 million, an increase of \$5 million. In addition, during both the nine month periods ended September 30, 2006 and 2005, revenue of approximately \$3 million was recorded from LAM general partnerships held directly by certain of our LAM managing directors, with these amounts being added as minority interest in net income.

Operating expenses were \$295 million for the 2006 period, an increase of \$50 million, or 20%, versus operating expenses of \$245 million for the corresponding period in 2005. Compensation and benefits expense increased by \$40 million or 30% as compared to the corresponding period in 2005. The increase was principally



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due to increases in accruals for performance-based bonus awards as a result of the increase in operating revenues as well as the inclusion, for periods subsequent to the consummation of the equity public offering, of all payments for services rendered by managing directors of LAM (and employee members of LAM), including distributions to profit participation members, in compensation and benefits expense which had previously been accounted for as minority interest in net income. All other operating expenses increased by \$9 million, or 8%, versus the corresponding period in 2005, principally due to higher professional fees for outsourced services and legal fees.

Asset Management operating income was \$82 million for 2006 period, flat versus operating income of \$82 million for the corresponding period in 2005. Operating income as a percentage of segment net revenue was 22%

for the 2006 period versus 25% for the corresponding period in 2005, with the decline in the 2006 period attributable to the increase in recorded compensation expense in the 2006 period as described above, partially offset by higher revenues versus the corresponding period in 2005. As stated above, historical results for periods prior to the equity public offering on May 10, 2005 and subsequent thereto are not comparable.

### **Cash Flows**

The Company's cash flows are influenced primarily by the timing of receipt of Financial Advisory and Asset Management fees, the timing of distributions to shareholders and payment of bonuses to employees. The M&A and Asset Management fee receivable collection period generally is 60 days or less. However, the collection time for restructuring transactions may extend beyond 60 days, particularly those that involve bankruptcies due to issues such as court-ordered holdbacks. In addition, fee receivables from our private fund advisory activities are generally collected over a four year period.

Cash and cash equivalents were \$530 million at September 30, 2006, an increase of \$38 million versus cash and cash equivalents of \$492 million at December 31, 2005. During the nine month period ended September 30, 2006, cash of \$147 million was provided by operating activities, comprised of (i) \$56 million provided from net income, (ii) approximately \$126 million provided by noncash charges, principally consisting of depreciation and amortization of \$11 million relating to property, \$18 million relating to the amortization of deferred expenses, stock units and an interest rate hedge, and approximately \$111 million relating to minority interest in net income, with these items being partially offset by the \$14 million gain on the termination of the Intesa joint venture, and (iii) partially offset by \$35 million being used by net changes in other operating assets and operating liabilities. Cash of \$5 million was used for investing activities, principally for net acquisitions of property. Financing activities during the period used cash of \$112 million, primarily for distributions to minority interest holders, repayments of senior borrowings and Class A common stock dividends. Exchange rate changes provided cash of \$8 million. The Company traditionally makes payments for employee bonuses and distributions to members and minority interest holders primarily in the first four months of the year with respect to the prior year's results.

### **Liquidity and Capital Resources**

Historically, the Company's source of liquidity has been cash provided by operations, with a traditional seasonal pattern of cash flow. While employee salaries are paid throughout the year, annual discretionary bonuses have historically been paid to employees in January following year-end. The Company's managing directors are paid a salary during the year, but a majority of their annual cash distributions with respect to the prior year have historically been paid to them in three monthly installments in February, March and April following year-end. In addition, and to a lesser extent, during the year we pay certain tax advances on behalf of our managing directors, and these advances serve to reduce the amounts due to the managing directors in the three installments described above. As a consequence, our level of cash on hand generally decreases significantly during the first four months of the year and gradually builds up over the remainder of the year. We expect this seasonal pattern of cash flow to continue.

We regularly monitor our liquidity position, including cash levels, credit lines, principal investment commitments, interest and principal payments on debt, capital expenditures and matters relating to liquidity and

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to compliance with regulatory net capital requirements. We maintain lines of credit in excess of anticipated liquidity requirements. As of September 30, 2006, Lazard had \$234 million in unused lines of credit available to it, including \$52 million of unused lines of credit available to LFB.

Lazard's annual cash flow generated from operations historically has been sufficient to enable it to meet its annual obligations. We believe that our cash flows from operating activities, including use of our credit lines as needed, should be sufficient for us to fund our current obligations for the next 12 months and beyond. As noted above, we intend to maintain lines of credit that can be utilized should the need arise. Concurrent with the equity public offering, Lazard Group entered into a five year, \$125 million senior revolving credit facility with a group of lenders, with such revolving credit facility being amended on May 17, 2006 to provide for aggregate commitments of \$150 million. As of September 30, 2006 there were no amounts outstanding under this credit facility. The senior revolving credit facility contains customary affirmative and negative covenants and events of default for facilities of this type. In addition, the senior revolving credit facility, among other things, limits the ability of the borrower to incur debt, grant liens, pay dividends, enter into mergers or to sell all or substantially all of its assets and contains financial covenants that must be maintained. We may, to the extent required and subject to restrictions contained in our financing arrangements, use other financing sources in addition to any new credit facilities.

On May 15, 2006, Lazard Group completed the termination of its joint venture relationship with Intesa, in accordance with the provisions of the Termination Agreement, dated as of March 31, 2006, by and among Intesa, Lazard Group and Lazard Italy. In connection with the termination, the following adjustments were made to the terms of Intesa's investment in Lazard Italy and Lazard Funding:

The existing \$150 million subordinated convertible note of Lazard Funding Limited LLC, a wholly-owned subsidiary of Lazard Group, held by Intesa was amended and restated, among other things, to provide for its convertibility into shares of Class A common stock at an effective conversion price of \$57 per share. The amended \$150 million subordinated convertible note (the "Amended \$150 million Subordinated Convertible Note") matures on September 30, 2016 and has a fixed interest rate of 3.25% per annum. One-third in principal amount will generally be convertible after July 1, 2008, an additional one-third after July 1, 2009 and the last one-third after July 1, 2010, and no principal amount will be convertible after June 30, 2011. Lazard Ltd will enter into a Registration Rights Agreement with Intesa providing for certain customary registration rights with respect to the shares of Class A common stock Intesa receives upon conversion. The Guaranty of the existing note by Lazard Group was also amended and restated to reflect the terms of the Amended \$150 million Subordinated Convertible Note. The covenants and events of default in the Amended \$150 million Subordinated Convertible Note were not materially changed.

Intesa's 40% equity interest in Lazard Italy and the \$50 million Subordinated Promissory Note of Lazard Italy held by Intesa were acquired by Lazard Group in exchange for the issuance to Intesa of a \$96 million senior promissory note of Lazard Group due February 28, 2008 (the "\$96 million Senior Promissory Note") and a \$50 million subordinated promissory note of Lazard Group due February 28, 2008 (the "\$50 million Subordinated Promissory Note"), respectively. The \$96 million Senior Promissory Note and the \$50 million Subordinated Promissory Note have fixed interest rates of 4.25% and 4.6% per annum, respectively, and each Note contains customary events of default for indebtedness of its type. On May 15, 2006, Intesa sold and assigned all its rights and interests relating to the \$96 million Senior Promissory Note and the \$50 million Subordinated Promissory Note to a commercial bank.

Lazard Group paid Intesa an amount equal to a 3% annualized return on the Intesa JV Interest from April 1, 2006 through the termination closing and the accrued and unpaid interest on the \$50 million Subordinated Promissory Note as of the termination closing.

As a result of the termination of the joint venture relationship and Lazard Group's repurchase of the Intesa JV Interest, the Company realized a gain of approximately \$14 million, excluding transaction and other costs,

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which is included in revenue other on the unaudited condensed consolidated statements of income for the nine month period ended September 30, 2006 (with all of such gain being recorded in the second quarter of 2006) and, after transaction and other costs, this transaction increased operating income by approximately \$5 million. See Note 5 of Notes to Unaudited Condensed Consolidated Financial Statements for further information.

As of September 30, 2006, Lazard was in compliance with all of its obligations under its various borrowing arrangements.

On February 7, 2006, the Board of Directors of Lazard Ltd authorized the repurchase of up to \$100 million in aggregate cost of the Lazard Ltd's Class A common stock. The Company's intention is that the share repurchase program will be used primarily to offset shares to be issued under Lazard Ltd's 2005 Equity Incentive Plan. Purchases may be made in the open market or through privately negotiated transactions in 2006 and 2007. During the nine month period ended September 30, 2006, Lazard Group purchased 115,000 shares of Class A common stock in the open market at an average price of \$36.34 per share.

We actively monitor our regulatory capital base. Our principal subsidiaries are subject to regulatory requirements in their respective jurisdictions to ensure their general financial soundness and liquidity, which require, among other things, that we comply with certain minimum capital requirements, record-keeping, reporting procedures, relationships with customers, experience and training requirements for employees and certain other requirements and procedures. These regulatory requirements may restrict the flow of funds to affiliates. Regulatory approval is generally required for paying dividends in excess of certain established levels. See Note 13 of Notes to Unaudited Condensed Consolidated Financial Statements for further information. These regulations differ in the U.S., the U.K., France, and other countries in which we operate. Our capital structure is designed to provide each of our subsidiaries with capital and liquidity consistent with its business and regulatory requirements. For a discussion of regulations relating to us, see Item 1-Business Regulation included in the Form 10-K.

Net revenue and operating income historically have fluctuated significantly between quarters. This variability arises from the fact that transaction completion fees comprise the majority of our net revenue, with the billing and recognition of such fees being dependent upon the successful completion of client transactions, the occurrence and timing of which is irregular and not subject to Lazard's control. In addition, incentive fees earned on AUM and compensation related thereto are generally not recorded until the end of the applicable measurement period, which is generally the fourth quarter of Lazard's fiscal year, when potential uncertainties regarding the ultimate realizable amounts have been determined.

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The following table sets forth information relating to Lazard's contractual obligations as of December 31, 2005 (see Note (e) below for updated information):

	Contractual Obligations Payment Due by Period				
	Total	Less than	1-3 Years	3-5 Years	More than 5
		1 Year			Years
	(\$ in thousands)				
Operating Leases (exclusive of \$70,546 of sublease income)	\$ 491,977	\$ 57,815	\$ 107,637	\$ 84,334	\$ 242,191
Capital Leases (including interest)	34,584	2,491	4,982	4,982	22,129
Senior Debt (including interest)	1,458,307	72,754	555,730(a)	108,376	721,447
Subordinated Loans (including interest)	258,192	6,000	60,644(b)	9,000	182,548(b)
Repurchase of Equity Interest in Lazard Italy	100,000		100,000(b)		
Merchant Banking Commitments LAI managed funds (c)	126,289	44,118	82,171		
Merchant Banking Commitments company sponsored funds	4,622	3,873		716	33
Contractual Commitments to Managing Directors, Senior Advisors, Employees and Other (d)	83,395	50,939	29,995	1,016	1,445
<b>Total (e)</b>	<b>\$ 2,557,366</b>	<b>\$ 237,990</b>	<b>\$ 941,159</b>	<b>\$ 208,424</b>	<b>\$ 1,169,793</b>

- (a) Includes \$437.5 million relating to Lazard Group Notes issued in connection with the issuance of the ESUs, for which the maturity date of the debt component can vary based on a remarketing of the Lazard Group Notes, and will mature (1) in the event of a successful remarketing, on any date no earlier than May 15, 2010 and no later than May 15, 2035, as we may elect, (2) in the event of a failed remarketing, on May 15, 2008 and (3) otherwise on May 15, 2035. While the Company currently expects a successful remarketing of the Lazard Group Notes, for purposes of the table above, a maturity in 2008, the earliest possible date, was assumed to be the maturity date of the Lazard Group Notes.
- (b) The contractual obligation table above is based on amounts outstanding as of December 31, 2005, including the then estimated amount required to repurchase the equity interest in Lazard Italy. Accordingly, the table does not include developments subsequent to December 31, 2005 relating to the Termination Agreement entered into with Intesa on May 15, 2006. See Liquidity and Capital Resources and Note 5 of Notes to Unaudited Condensed Consolidated Financial Statements. The table includes interest expense based on the terms in effect as of December 31, 2005, which provided for interest on (i) the \$50 million subordinated promissory note at its fixed rate of interest of 3.0% per annum through February 4, 2008 and (ii) the \$150 million subordinated convertible note through its scheduled maturity date of March 26, 2018, at its minimum annual interest rate of 3% per annum based on the terms in effect as of December 31, 2005. See Note (e) 8 below for information relating to the termination of the Intesa joint venture.
- (c) Pursuant to the business alliance agreement, Lazard Group has commitments to fund certain investment funds managed by Lazard Alternative Investments Holdings LLC ( LAI ). Amounts in the table above relate to (1) obligations related to Corporate Partners II Limited, a private equity fund formed on February 25, 2005, with \$1 billion of institutional capital commitments and a \$100 million capital commitment from us, the principal portion of which may require funding at any time through 2010 (as of December 31, 2005, Lazard Group contributed approximately \$0.1 million of its capital commitment). For purposes of the table above, Lazard's remaining commitment of approximately \$99.9 million as of December 31, 2005 was estimated to be funded in the amounts of \$37.5 million, \$37.5 million, and \$24.9 million in the years ending December 31, 2006, 2007 and 2008, respectively; (2) obligations related to the Lazard Senior Housing Partners LP, a private equity fund formed in July 2005, with capital commitments of \$201 million, including, as estimated as of December 31, 2005, a minimum and maximum capital commitment from us of \$10 million and \$27 million, respectively, the principal portion of which will require funding at any time through 2008 (as of December 31, 2005, Lazard Group contributed its initial

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- capital commitment which amounted to approximately \$0.6 million. For purposes of this table, included is the then estimated maximum remaining commitment of \$27 million and Lazard's remaining maximum commitment of approximately \$26.4 million as of December 31, 2005 was estimated to be funded in the amounts of \$6.6 million, \$18.7 million, and \$1.1 million in the years ending December 31, 2006, 2007 and 2008, respectively.
- (d) The Company has agreements for the years shown in the table above relating to future minimum distributions to certain managing directors and compensation to certain employees incurred for the purpose of recruiting and retaining these senior professionals. Also included are guaranteed compensation arrangements with advisors and a commitment to a former managing director.
- (e) The table above does not include:
- (1) any contingent obligations relating to the LAM equity rights;
  - (2) any potential payment related to the IXIS cooperation arrangement (the level of this contingent payment to IXIS would depend, among other things, on the level of revenue generated by the cooperation activities, and the potential payment is limited, as of September 30, 2006, to a maximum of approximately \$8 million (subject to further reduction in certain circumstances) which would only occur if the cooperation activities generate no revenue over the course of the remaining initial period of such activities, the cooperation agreement is not renewed and Lazard Ltd's stock price fails to sustain certain price levels);
  - (3) any contingent limited partner capital commitments as described in Note 7 of Notes to Consolidated Financial Statements included in the Form 10-K;
  - (4) interest expense relating to Lazard Group's revolving credit agreement, which is a variable rate obligation;
  - (5) the lending commitments and indemnifications provided by LFB to third parties as described in Note 12 of Notes to Consolidated Financial Statements included in the Form 10-K;
  - (6) with respect to obligations related to (a) Corporate Partners II Limited, as described in Note(c)(1) above, Lazard Group has contributed an additional \$1.2 million of its capital commitment during the nine month period ended September 30, 2006. Lazard's remaining commitment of \$98.7 million is currently estimated to be funded in the amounts of \$8.7 million in the fourth quarter of 2006 and \$45 million in each of the years ending December 31, 2007 and 2008, and (b) Lazard Senior Housing Partners LP, as described in Note (c)(2) above, Lazard Group has contributed an additional \$1.6 million of its capital commitment during the nine month period ended September 30, 2006. In addition, the Company's maximum commitment has been reduced from \$27 million to \$10 million, with Lazard's remaining commitment of \$7.8 million now estimated to be funded in the year ending December 31, 2007;
  - (7) additional guaranteed compensation arrangements entered into during the nine month period ended September 30, 2006, that requires additional payments of \$25.1 million, \$10.2 million and \$1.8 million for 2006, 2007 and 2008, respectively; and
  - (8) additional indebtedness and changes to the terms of existing indebtedness resulting from the May 15, 2006 termination of the Intesa joint venture relationship (see Note 5 of Notes to Unaudited Condensed Consolidated Financial Statements). Such additional indebtedness relates to the \$96 million Senior Promissory Note due February 28, 2008, with interest expense at the rate of 4.25% per annum. Changes to the terms of existing indebtedness relates to (i) the \$50 million Subordinated Promissory Note, the maturity date for which was changed to February 28, 2008 and the interest rate for which was changed to 4.6% per annum and (ii) the Amended \$150 million Subordinated Convertible Note, the maturity date for which was changed to September 30, 2016, and the interest rate for which was fixed at 3.25% per annum.

In addition the table above does not include any recognition of the May, 2008 settlement of the purchase contracts component of the ESUs which require the holders to purchase an aggregate of \$437.5 million of the Company's Class A common stock for cash or exchange of outstanding debt, depending on the success of the remarketing of such debt - see Note (a) above. This obligation is collateralized by the entire \$437.5 million principal amount of Lazard Group Notes outstanding.

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### **Critical Accounting Policies and Estimates**

Management's discussion and analysis of our consolidated financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in conformity with U.S. GAAP. The preparation of Lazard's consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, Lazard evaluates its estimates, including those related to revenue recognition, compensation liabilities, income taxes, investing activities and goodwill. Lazard bases these estimates on historical experience and various other assumptions that it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

Lazard believes that the critical accounting policies set forth below comprise the most significant estimates and judgments used in the preparation of its consolidated financial statements.

#### ***Revenue Recognition***

Lazard generates substantially all of its net revenue from providing financial advisory and asset management services to clients. Lazard recognizes revenue when the following criteria are met:

there is persuasive evidence of an arrangement with a client,

the agreed-upon services have been provided,

fees are fixed or determinable, and

collection is probable.

Lazard's clients generally enter into agreements with Lazard that vary in duration depending on the nature of the service provided. Lazard typically bills clients for the full amounts due under the applicable agreements on or after the dates on which the specified service has been provided. Generally, payments are collected within 60 days of billing (or over longer periods of time with respect to billings related to restructurings and our private fund advisory activities). The Company also earns performance-based incentive fees on some investment products, such as hedge funds and merchant banking funds. Incentive fees on hedge funds generally are recorded at the end of the year, when potential uncertainties regarding the ultimate realizable amounts have been determined, and typically are calculated based on a specified percentage of a fund's net appreciation during the year. Incentive fees on hedge funds generally are subject to loss carry-forward provisions in which losses incurred by the funds in any year are applied against future period net appreciation before any incentive fees can be earned.

Lazard assesses whether collection is probable based on a number of factors, including past transaction history with the client and an assessment of the client's current creditworthiness. If, in Lazard's judgment, collection of a fee is not probable, Lazard will not recognize revenue until the uncertainty is removed. In rare cases, an allowance for doubtful collection may be established, for example, if a fee is in dispute or litigation has commenced.

#### ***Income Taxes***

As part of the process of preparing its consolidated financial statements, Lazard is required to estimate its income taxes in each of the jurisdictions in which it operates. This process requires Lazard to estimate its actual current tax liability and to assess temporary differences resulting from differing book versus tax treatment of items, such as deferred revenue, compensation and benefits expense, unrealized gains on long-term investments and depreciation. These temporary differences result in deferred tax assets and liabilities, which are included within Lazard's consolidated statements of financial condition. Lazard must then assess the likelihood that its deferred tax assets will be recovered from future taxable income, and, to the extent it believes that recovery is not more likely than not, Lazard must establish a valuation allowance. Significant management judgment is required in determining Lazard's provision for income taxes, its deferred tax assets and liabilities and any valuation allowance recorded against its net deferred tax assets. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized and, when necessary, valuation allowances

are established. The ultimate realization of the deferred tax

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assets is dependent upon the generation of future taxable income during the periods in which temporary differences become deductible. Management considers the level of historical taxable income, scheduled reversals of deferred taxes, projected future taxable income and tax planning strategies that can be implemented by the Company in making this assessment. If actual results differ from these estimates or Lazard adjusts these estimates in future periods, Lazard may need to adjust its valuation allowance, which could materially impact Lazard's consolidated financial position and results of operations.

In addition, in order to determine the quarterly tax rate, Lazard is required to estimate full year pre-tax income and the related annual income tax expense in each jurisdiction. Tax exposures can involve complex issues and may require an extended period of time to resolve. Changes in the geographic mix or estimated level of annual pre-tax income can affect Lazard's overall effective tax rate. Significant management judgment is required in determining Lazard's provision for income taxes, its deferred tax assets and liabilities and any valuation allowance recorded against its net deferred tax assets. Furthermore, Lazard's interpretation of complex tax laws may impact its measurement of current and deferred income taxes.

### ***Valuation of Investments***

Long-term investments consist principally of investments in merchant banking and alternative investment funds, and other privately managed investments. These investments are carried at fair value on the consolidated statements of financial condition, with unrealized gains and losses reflected net on the consolidated statements of income. Gains and losses on long-term investments, which arise from changes in the fair value of the investments, are not predictable and can cause periodic fluctuations in net income (net income allocable to members of Lazard Group prior to May 10, 2005).

Where applicable, the fair value of a publicly traded investment is determined by quoted market prices. Most of the Company's investments included in long-term investments, however, are not publicly traded and, as a result, are valued based upon management's best estimate. The fair value of such investments is based upon an analysis of the investee's financial results, condition, cash flows and prospects. The carrying value of such investments is adjusted when changes in the underlying fair values are readily ascertainable, generally as evidenced by third party transactions or transactions that directly affect the value of such investments. Adjustments also are made, in the absence of third-party transactions, if Lazard determines that the expected realizable value of the investment differs from its carrying value. In reaching that determination, Lazard considers many factors, including, but not limited to, the operating cash flows and financial performance of the investee, expected exit timing and strategy, and any specific rights or terms associated with the investment, such as conversion features and liquidation preferences. The Company's investments in partnership interests, including general partnership and limited partnership interests in real estate funds, are recorded at fair value based on changes in the fair value of the partnerships' underlying net assets.

Because of the inherent uncertainty in the valuation of investments that are not readily marketable, estimated values may differ significantly from the values that would have been reported had a ready market for such investments existed. Lazard seeks to maintain the necessary resources, with the appropriate experience and training, to ensure that control and independent price verification functions are adequately performed.

### ***Goodwill***

In accordance with Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets*, goodwill is tested for impairment annually or more frequently if circumstances indicate impairment may have occurred. In this process, Lazard makes estimates and assumptions in order to determine the fair value of its assets and liabilities and to project future earnings using valuation techniques, including a discounted cash flow model. Lazard uses its best judgment and information available to it at the time to perform this review. Because Lazard's assumptions and estimates are used in projecting future earnings as part of the valuation, actual results could differ.



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***Consolidation of VIEs***

The consolidated financial statements include the accounts of Lazard Group and all other entities in which we are the primary beneficiary or control. Lazard determines whether it has a controlling financial interest in an entity by first evaluating whether the entity is a voting interest entity or a variable interest entity ( VIE ) under U.S. GAAP.

**Voting Interest Entities.** Voting interest entities are entities in which (i) the total equity investment at risk is sufficient to enable the entity to finance itself independently and (ii) the equity holders have the obligation to absorb losses, the right to receive residual returns and the right to make decisions about the entity's activities. Voting interest entities are consolidated in accordance with Accounting Research Bulletin ( ARB ) No. 51, *Consolidated Financial Statements*, as amended by SFAS No. 94, *Consolidated Financial Statements*. ARB No. 51 states that the usual condition for a controlling financial interest in an entity is ownership of a majority voting interest. SFAS No. 94 amends ARB No. 51 to require consolidation of all majority-owned subsidiaries unless control is temporary or does not rest with the majority owner. SFAS No. 94 also requires consolidation of a majority-owned subsidiary even if it has non-homogeneous operations, a large minority interest, or a foreign location. Accordingly, Lazard consolidates voting interest entities in which it has the majority of the voting interest in accordance with ARB No. 51 and SFAS No. 94.

**Variable Interest Entities.** VIEs are entities that lack one or more of the characteristics of a voting interest entity. A controlling financial interest in a VIE is present when an enterprise has a variable interest, or a combination of variable interests, that will absorb a majority of the VIE's expected losses, receive a majority of the VIE's expected residual returns, or both. The enterprise with a controlling financial interest, known as the primary beneficiary, consolidates the VIE.

Lazard determines whether it is the primary beneficiary of a VIE by first performing a qualitative analysis of the VIE that includes, among other factors, its capital structure, contractual terms, and related party relationships. Where qualitative analysis is not conclusive, Lazard performs a quantitative analysis. For purposes of allocating a VIE's expected losses and expected residual returns to the VIE's variable interest holders, Lazard calculates its share of the VIE's expected losses and expected residual returns using a cash flows model that allocates those expected losses and residual returns to it, based on contractual arrangements and/or Lazard's position in the capital structure of the VIE under various scenarios. Lazard would reconsider its assessment of whether it is the primary beneficiary if there are changes to any of the variables used in determining the primary beneficiary. Those variables may include changes to financial arrangements, contractual terms, capital structure and related party relationships.

In accordance with FASB Interpretation No. 46R the assets, liabilities and results of operations of the VIE are included in the consolidated financial statements of Lazard if it is determined that we are the primary beneficiary. Any third party interest in these consolidated entities is reflected as minority interest in our consolidated financial statements.

Lazard is involved with various entities in the normal course of business that are VIEs and hold variable interests in such VIEs. Transactions associated with these entities primarily include investment management, real estate and private equity investments. Those VIEs for which Lazard was the primary beneficiary were consolidated at December 31, 2004 in accordance with FIN 46R. Those VIEs included company sponsored venture capital investment vehicles established in connection with Lazard's compensation plans. In connection with the separation, Lazard Group transferred its general partnership interests in those VIEs to a subsidiary of LFCM Holdings. Lazard Group has determined that it is no longer the primary beneficiary with respect to those VIEs and, as a result, the Company no longer consolidates such VIEs.

**Table of Contents****Risk Management**

We encounter risk as part of the normal course of our business and we design risk management processes to help manage such risks considering both the nature of our business and our operating model. The Company is subject to varying degrees of credit, market, operational and liquidity risks (see *Liquidity and Capital Resources*) and monitors these risks on a consolidated basis. Management within each of Lazard's operating locations are principally responsible for managing the risks within its respective businesses on a day-to-day basis.

**Market and Credit Risks**

Lazard, in general, is not a capital-intensive organization and as such, is not subject to significant credit or market risks. Nevertheless, Lazard has established procedures to assess both the credit and market risk, as well as specific interest rate, currency and credit limits related to various positions.

With respect to LFB's operations, LFB engages in banking activities that primarily include investing in securities, deposit taking and lending. In addition, LFB may take open foreign exchange positions with a view to profit, but does not sell foreign exchange options in this context, and enters into forward foreign exchange contracts, interest rate swaps, cross-currency interest rate swaps and other derivative contracts to hedge exposures to interest rate and currency fluctuations.

At September 30, 2006, substantially all of the \$390 million of securities owned, at fair value, were fixed-income securities within LFB's portfolio, 91% of which were rated investment grade credit quality. At December 31, 2005, substantially all of the \$272 million of securities owned, at fair value, were fixed-income securities within the LFB portfolio, 92% of which were rated investment grade credit quality.

At September 30, 2006 and December 31, 2005, derivative contracts, all of which related to LFB's operations and which are recorded at fair value, were as follows:

	September 30, 2006	December 31, 2005
	(\$ in thousands)	
<b>Assets:</b>		
Interest rate swap contracts	\$ 111	\$ 186
<b>Liabilities:</b>		
Interest rate swap contracts	\$ 718	\$ 3,028

The primary market risks associated with LFB's securities inventory, foreign exchange, hedging and securities financing activities are sensitivity to changes in the general level of credit spreads and, with respect to foreign currency risk, specific exchange rate spreads. The risk management strategies that we employ use various risk sensitivity metrics to measure such risks and to examine behavior under significant adverse market conditions.

LFB's annual interest rate risk, as measured by a 1% +/- change in interest rates, amounted to approximately \$764 thousand and \$93 thousand as of September 30, 2006 and December 31, 2005, respectively.

Foreign currency risk associated with LFB's open positions, in aggregate, as measured by a 2% +/- change against the U.S. dollar, amounted to approximately \$33 thousand and \$2 thousand as of September 30, 2006 and December 31, 2005, respectively. LFB fully collateralizes its repurchase transactions with fixed income securities.

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**Table of Contents*****Risks Related to Receivables***

We maintain an allowance for bad debts to provide coverage for probable losses from our fee and customer receivables, including our lending portfolio in LFB. We determine the adequacy of the allowance by estimating the probability of loss based on management's analysis of the client's creditworthiness and specifically reserve against exposures where, in our judgment, the receivables are impaired. At September 30, 2006 total receivables amounted to \$691 million, net of an allowance for bad debts of \$14 million. As of that date, inter-bank lending, financial advisory and asset management fee, customer receivables and related party receivables comprised 48%, 40%, 10% and 2% of total receivables, respectively. At December 31, 2005 total receivables amounted to \$748 million, net of an allowance for bad debts of \$13 million. As of that date, inter-bank lending, financial advisory and asset management fee, and customer receivables and related party receivables comprised 46%, 38%, 9% and 7% of total receivables, respectively.

***Credit Concentration***

To reduce the exposure to concentrations of credit from banking activities within LFB, the Company has established limits for corporate counterparties and monitors the exposure against such limits. At September 30, 2006 the Company had no exposure to an individual counterparty that exceeded \$42 million, in the aggregate, excluding inter-bank counterparties.

***Risks Related to Short-Term Investments and Corporate Indebtedness***

A significant portion of the Company's interest-bearing liabilities has fixed interest rates or maximum interest rates, while its cash and short-term investments generally have floating interest rates. Lazard estimates that operating income relating to cash and short-term investments and corporate indebtedness balances as of September 30, 2006 would change by approximately \$4 million, on an annual basis, in the event interest rates were to increase or decrease by 1%.

***Operational Risks***

Operational risk is inherent in all our businesses and may, for example, manifest itself in the form of errors, breaches in the system of internal controls, business interruptions, fraud or legal actions due to operating deficiencies or noncompliance. The Company maintains a framework including policies and a system of internal controls designed to monitor and manage operational risk and provide management with timely and accurate information. Management within each of the operating companies is primarily responsible for its operational risk programs. The Company has in place a business continuity and disaster recovery programs that manages its capabilities to provide services in the case of a disruption. We purchase insurance programs designed to protect the Company against accidental loss and losses, which may significantly affect our financial objectives, personnel, property, or our ability to continue to meet our responsibilities to our various stakeholder groups.

***Recently Issued Accounting Standards***

***Share-Based Payments*** In December 2004, the Financial Accounting Standards Board, ( FASB ) issued SFAS No. 123R, *Share-Based Payments* ( SFAS 123R ). SFAS 123R is a revision of SFAS No. 123, *Accounting for Stock-Based Compensation* ( SFAS 123 ), and supersedes Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* ( APB 25 ), and its related guidance. SFAS 123R is effective for the Company's fiscal year beginning January 1, 2006. Prior to May 10, 2005, the date of the equity public offering, Lazard operated as a series of related partnerships under the control of the partners and Lazard did not have a capital structure that permitted share based compensation. In connection with equity awards granted pursuant to the Company's 2005 Equity Incentive Plan (described in more detail in Note 8 of Notes to Unaudited Condensed Consolidated Financial Statements), the Company adopted the fair value recognition provisions under SFAS 123. Accordingly, subsequent to the dates of grant during 2005, Lazard recognized in compensation expense the amortized portion of the fair value of the equity awards, net of an estimated forfeiture rate, over the service period specified in the award.

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Effective for the first quarter of 2006, Lazard adopted SFAS 123R. Under SFAS 123R, share-based awards that do not require future service are expensed immediately. Share-based employee awards that require future service are amortized over the requisite service period. Lazard adopted SFAS 123R under the modified prospective method. Under that method, the provisions of SFAS 123R are applied to share-based awards granted subsequent to adoption. Share-based awards granted to employees prior to the adoption of SFAS 123R must continue to be amortized over the stated service periods of the awards, however, should the awards vest upon retirement, any unamortized cost would be recognized when the employee retires.

Additionally, SFAS 123R changed SFAS 123 by eliminating alternative methods for recognition of the costs of equity awards and recognition of award forfeitures. First, SFAS 123R changed SFAS 123 by precluding the use of the intrinsic method as provided for under APB 25 and requiring fair value recognition. Second, SFAS 123R differed from SFAS 123 by precluding the recognition of forfeitures on an actual basis by requiring the application of an estimated forfeiture rate to the amortizable cost of the award for all unvested awards. The Company adopted both the fair value recognition and the estimated forfeiture rate methods required under SFAS 123R in 2005 while accounting for equity awards under the provisions of SFAS 123.

SFAS 123R also requires that the benefits of tax deductions in excess of recognized compensation costs to be reported as a financing cash flow, rather than as an operating cash flow as prescribed under prior accounting standards. This requirement reduces net operating cash flows and increases net financing cash flows in periods beginning with and subsequent to adoption of SFAS 123R. Total net cash flow remains unchanged from what would have been reported under prior accounting rules.

As a result of the Company adopting certain provisions consistent with SFAS 123R upon the introduction of its 2005 Equity Incentive Plan while under the provisions of SFAS 123, there is no significant effect resulting from the adoption of the provisions of SFAS 123R.

***Investments in Limited Partnerships*** On January 1, 2006, the Company adopted, as required, the provisions of Emerging Issues Task Force ( EITF ) Issue No. 04-5, *Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or, Similar Entity When the Limited Partners Have Certain Rights* ( EITF 04-5 ). The EITF consensus requires a general partner in a limited partnership to consolidate the limited partnership unless the presumption of control is overcome. The general partner may overcome this presumption of control and not consolidate the entity if the limited partners have: (a) the substantive ability to dissolve or liquidate the limited partnership or otherwise remove the general partner without having to show cause; or (b) substantive participating rights in managing the partnership. EITF 04-5 was effective for general partners of all newly-formed limited partnerships and for existing limited partnerships for which the partnership agreements are modified after June 29, 2005, and for general partners in all other limited partnerships, no later than the beginning of the first reporting period in fiscal years beginning after December 15, 2005. The adoption of the provisions of EITF 04-5 did not have a material impact on the Company's unaudited condensed consolidated financial statements.

### **Recent Accounting Pronouncements**

In February 2006, the FASB issued SFAS No. 155 *Accounting for Certain Hybrid Financial Instruments – an amendment of FASB Statements No. 133 and 140* ( SFAS 155 ). SFAS 155 permits an entity to measure at fair value any financial instrument that contains an embedded derivative that otherwise would require bifurcation. SFAS 155 is effective for all financial instruments acquired or issued in fiscal years beginning after September 15, 2006. The impact of adopting SFAS 155 is not expected to have a material impact on the financial condition, results of operations, and cash flows of the Company.

In March 2006, the FASB issued SFAS No. 156 *Accounting for Servicing of Financial Assets – an amendment of FASB Statement No. 140* ( SFAS 156 ), which requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable, and for subsequent measurements, permits an entity to choose either the amortization method or the fair value measurement method for each class

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of separately recognized servicing assets and servicing liabilities. SFAS 156 also requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional disclosures for all separately recognized servicing assets and servicing liabilities. SFAS 156 is effective in fiscal years beginning after September 15, 2006. The impact of adopting SFAS 156 is not expected to have a material impact on the financial condition, results of operations, and cash flows of the Company.

In July 2006, the FASB issued FIN No. 48 *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109* ( FIN 48 ) which clarifies the criteria that must be met prior to recognition of the financial statement benefit of a tax position taken in a tax return. FIN 48 provides a benefit recognition model with a two-step approach consisting of a more-likely-than-not recognition criteria, and a measurement attribute that measures the position as the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement. FIN 48 also requires the recognition of liabilities created by differences between tax positions taken in a tax return and amounts recognized in the financial statements. FIN 48 is effective as of the beginning of the first annual period beginning after December 15, 2006. We are currently assessing the impact of adopting FIN 48 on the financial condition, results of operations, and cash flows of the Company.

In September 2006, FASB issued SFAS No. 157 *Fair Value Measurements* ( SFAS 157 ). SFAS 157 defines fair value, establishes a framework for measuring fair value, and enhances disclosures about fair value measurements. This Statement applies to other accounting pronouncements that require the use of fair value measurements. SFAS 157 is effective for interim and annual financial statements issued for fiscal years beginning after November 15, 2007. We are currently assessing the impact of adopting SFAS 157 on the financial condition, results of operations, or cash flows of the Company.

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Post-retirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R)* ( SFAS 158 ). SFAS 158 requires an entity to recognize in its statement of financial condition the funded status of its defined benefit post-retirement plans, measured as the difference between the fair value of the plan assets and the applicable benefit obligations. SFAS 158 also requires an entity to recognize changes in the funded status of a defined benefit post-retirement plan within accumulated other comprehensive income, net of tax, to the extent such changes are not recognized in earnings as components of periodic net benefit cost. SFAS 158 is effective for interim and annual financial statements issued for fiscal years ending after December 15, 2006. We are currently assessing the impact of adopting SFAS 158 on the financial condition, results of operations, or cash flows of the Company.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108 *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* ( SAB 108 ). SAB 108 permits the Company to adjust for the cumulative effect of immaterial errors relating to prior years in the carrying amount of assets and liabilities as of the beginning of the current fiscal year, with an offsetting adjustment to the opening balance of retained earnings in the year of adoption. SAB 108 also requires the adjustment of any prior quarterly financial statements within the fiscal year of adoption for the effects of such errors on the quarters when the information is next presented. Such adjustments do not require previously filed reports with the SEC to be amended. The Company is currently assessing the impact of adoption of SAB 108 on the financial condition, results of operations, and cash flows as of and for the year ended December 31, 2006.

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**Item 3. Quantitative and Qualitative Disclosures About Market Risk  
Risk Management**

Quantitative and qualitative disclosures about market risk are included under the caption Management's Discussion and Analysis of Financial Condition and Results of Operations Risk Management. Because the Capital Markets and Other segment was separated from the operations of the Company in connection with the separation on May 10, 2005, the market risks specific to the Capital Markets and Other segment no longer apply to the Company.

**Item 4. Controls and Procedures**

Our management, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 under the Exchange Act as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this quarterly report, our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) are effective, in all material respects, to ensure that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

In addition, no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) occurred during our most recent fiscal quarter that has materially affected, or is likely to materially affect, our internal control over financial reporting.

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**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

Our businesses, as well as the financial services industry generally, are subject to extensive regulation throughout the world. We are involved in a number of judicial, regulatory and arbitration proceedings and inquiries concerning matters arising in connection with the conduct of our businesses. We believe, based on currently available information, that the results of such proceedings, in the aggregate, will not have a material adverse effect on our financial condition but might be material to our operating results or cash flows for any particular period, depending upon the operating results for such period.

We received a request for information from the NASD as part of what we understand to be an industry investigation relating to gifts and gratuities, which is focused primarily on Lazard's former Capital Markets business, which business was transferred to LFCM Holdings as a part of the separation. In addition, we received requests for information from the NASD, SEC and the U.S. Attorney's Office for the District of Massachusetts seeking information concerning gifts and entertainment involving an unaffiliated mutual fund company, which are also focused on that same business. We believe that other broker-dealers also received requests for information. In the course of an internal review of these matters, there were resignations or discipline of certain individuals associated with Lazard's former Capital Markets business. These investigations are continuing and we cannot predict their potential outcomes, which outcomes, if any, could include the consequences discussed under the caption "Regulation" in our Annual Report on Form 10-K for the year ended December 31, 2005.

Lazard Ltd and Goldman Sachs & Co., the lead underwriter of Lazard Ltd's equity public offering of its common stock, as well as several members of Lazard Ltd's management and board of directors, have been named as defendants in several putative class action lawsuits and a putative stockholder derivative lawsuit filed in the U.S. District Court for the Southern District of New York, and in a putative class action lawsuit and a putative stockholder derivative lawsuit filed in the Supreme Court of the State of New York. The plaintiffs in the putative class action lawsuits filed in the U.S. District Court for the Southern District of New York have filed a consolidated amended complaint, and the defendants have filed a motion to dismiss that complaint. The defendants in the putative class action lawsuit filed in the Supreme Court of the State of New York have served plaintiffs with a motion to dismiss the complaint or, in the alternative, stay the action pending resolution of the putative class action in the U.S. District Court for the Southern District of New York. The putative class action lawsuits purport to have been filed on behalf of persons who purchased securities of Lazard Ltd in connection with the equity public offering or in the open market. The putative class actions allege various violations of the federal securities laws and seek, inter alia, compensatory damages, rescission or rescissory damages and other unspecified equitable, injunctive or other relief. The putative derivative actions purport to be brought on behalf of Lazard Ltd against its directors and Goldman Sachs & Co. and allege, among other things, that the directors breached their fiduciary duties to Lazard Ltd in connection with matters related to the equity public offering and seek compensatory damages, punitive damages and other unspecified equitable or other relief. We believe that the suits are without merit and intend to defend them vigorously.

**Item 1A. Risk Factors**

Except as discussed below, there were no material changes from the risk factors previously disclosed in the registrant's Annual Report on Form 10-K for the year ended December 31, 2005.

As previously disclosed, in 2004, the American Jobs Creation Act of 2004 was enacted, adding Section 7874 to the Internal Revenue Code. Under Section 7874, non-U.S. corporations meeting certain ownership, operational and other tests are treated as U.S. corporations for U.S. federal income tax purposes. Our Annual Report on Form 10-K for the fiscal year ended December 31, 2005 contained a Risk Factor that discussed, among other things, the risk that Lazard Ltd could be treated under Section 7874 as a U.S. corporation for U.S. federal income tax purposes. Based on the advice of our counsel, we believe that recent pronouncements by the Internal

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Revenue Service and the Treasury Department, which clarify that Lazard Ltd and similarly situated companies should not be subject to Section 7874, confirm our prior belief in this regard and we have revised the relevant risk factor as follows:

**In the event of a change or adverse interpretation of relevant income tax law, regulation or treaty, or a failure to qualify for treaty benefits, our overall tax rate may be substantially higher than the rate used for purposes of our consolidated financial statements.**

Our effective tax rate for 2006 and in our 2005 pro forma financial information included herein is based upon the application of currently applicable income tax laws, regulations and treaties and current judicial and administrative authorities interpreting those income tax laws, regulations and treaties and upon our non-U.S. subsidiaries' ability to qualify for benefits under those treaties. Moreover, those income tax laws, regulations and treaties, and the administrative and judicial authorities interpreting them, are subject to change at any time, and any such change may be retroactive.

As discussed above, our effective tax rate for 2006 and in our 2005 pro forma financial information included herein is also based upon our non-U.S. subsidiaries qualifying for treaty benefits. The eligibility of our non-U.S. subsidiaries for treaty benefits generally depends upon, among other things, at least 50% of the principal class of shares in such subsidiaries being ultimately owned by U.S. citizens and persons that are qualified residents for purposes of the treaty. It is possible that this requirement may not be met and even if it is met, we may not be able to document that fact to the satisfaction of the IRS. If our non-U.S. subsidiaries are not treated as eligible for treaty benefits, such subsidiaries will be subject to additional U.S. taxes, including branch profits tax on their effectively connected earnings and profits (as determined for U.S. federal income tax purposes) at a rate of 30% rather than a treaty rate of 5%.

The inability, for any reason, to achieve and maintain an overall income tax rate approximately equal to the rate used in preparing our financial statements and 2005 pro forma financial information could materially adversely affect our business and our results of operations and would materially adversely impact our financial statements and our 2005 pro forma financial information presented herein.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

Not applicable.



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**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Submission of Matters to a Vote of Security Holders**

None.

**Item 5. Other Information**

On November 6, 2006, Lazard Ltd, Lazard Group and LAZ-MD Holdings entered into certain modifications to the arrangements between each of the parties as requested by LAZ-MD Holdings on behalf of its members primarily related to the terms of exchangeability of the LAZ-MD Holdings exchangeable interests and the registration rights associated with the shares of Lazard Ltd common stock issuable upon exchange of those interests. The following is a summary of the material terms of the modifications, which have been approved by the boards of directors of Lazard Ltd, Lazard Group and LAZ-MD Holdings, and, in accordance with the terms of the LAZ-MD Holdings stockholders' agreement, the requisite vote of the holders of LAZ-MD Holdings exchangeable interests party thereto. The modifications involve changes to the following documents:

the stockholders' agreement dated as of May 10, 2005, by and among LAZ-MD Holdings, Lazard Ltd and certain members of LAZ-MD Holdings (the LAZ-MD Holdings stockholders' agreement),

the master separation agreement, dated as of May 10, 2005, by and among Lazard Ltd, LAZ-MD Holdings, Lazard Group and LFCM Holdings, as amended, and

the retention agreements entered into with each managing director of Lazard in connection with the equity public offering of Lazard Ltd.

The following summary of the material terms of the modifications to these agreements does not purport to be complete and is subject to, and qualified in its entirety by reference to, the provisions of the amended and restated LAZ-MD Holdings stockholders' agreement, the amendment to the master separation agreement and the acknowledgment letter regarding the retention agreements, which were entered into to effect the changes. Copies of these documents have been filed with the SEC as exhibits to this Quarterly Report on Form 10-Q.

**Amended and Restated LAZ-MD Holdings Stockholders' Agreement**

The amended and restated LAZ-MD Holdings stockholders' agreement, dated as of November 6, 2006 (the amended and restated stockholders' agreement) modified in certain respects the terms of the registration rights granted to holders of the LAZ-MD Holdings exchangeable interests who are party to that agreement. The changes include the following:

For purposes of determining what are registrable securities under the amended and restated stockholders' agreement, both shares of our common stock already issued in exchange for LAZ-MD Holdings exchangeable interests and shares of our common stock then issuable in exchange for LAZ-MD Holdings exchangeable interests are included.

The minimum number of registrable securities necessary to effect a demand registration is the lesser of (1) the number of shares having a market value in excess of \$50 million at such time (or \$20 million after the ninth anniversary of our equity public offering (May 10, 2014)) or (2) 2,000,000 shares of our common stock.

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Any amendments to the registration rights provisions of the amended and restated stockholders' agreement shall require the affirmative approval of holders holding two-thirds of the shares of Lazard Ltd common stock covered under the amended and restated stockholders' agreement in addition to the consent of Lazard Ltd and LAZ-MD Holdings, and any amendment that materially and adversely

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impacts the rights of any holder under the amended and restated stockholders' agreement will also require the consent of such holder or it will not apply to such person unless such amendment applies to and affects the rights of all holders equally, regardless of whether or not such person is providing services to Lazard Ltd.

Each holder of registrable securities party to the amended and restated stockholders' agreement may enforce his or her registration rights directly against Lazard Ltd, although LAZ-MD Holdings may elect to assume, seek and conduct the enforcement of any claims itself on behalf of such holder.

### **Amendment to the Master Separation Agreement**

On November 6, 2006, Lazard Ltd, Lazard Group and LAZ-MD Holdings entered into Amendment No. 1 to the master separation agreement (the "amendment"). The amendment modified the provisions of the master separation agreement relating to the exchange terms of the LAZ-MD Holdings exchangeable interests. The modifications include the following:

An exchange of LAZ-MD Holdings exchangeable interests may be conditioned upon the actual sale of all or any portion (such amount designated by the holder) of the LAZ-MD Holdings exchangeable interests in connection with a registered offering.

In addition, the amendment provides that holders of LAZ-MD Holdings exchangeable interests that are then exchangeable would be able to exchange them not only at annual registration periods but also in connection with demand and piggy-back registration opportunities and during window periods after the filing of selected Quarterly Reports on Form 10-Q and the Annual Report on Form 10-K by Lazard Ltd.

In addition to requiring the consent of Lazard Ltd, Lazard Group and LAZ-MD Holdings to amend the exchangeability provisions, any provisions that materially and adversely impact the rights of any holder thereunder would also need the consent of such holder or it will not apply to such person unless such amendment applies to and affects the rights of all holders equally, regardless of whether or not such person is providing services to Lazard Ltd.

### **Acknowledgment Letter Regarding the Retention Agreements**

On November 6, 2006, Lazard Group delivered to LAZ-MD Holdings an acknowledgement letter (the "acknowledgement letter") modifying the terms of the retention agreements of persons party to the amended and restated LAZ-MD stockholders' agreement who are currently managing directors. The modifications include Lazard Group's agreement that, in the event that any such person shall become entitled to exchangeability immediately following the third anniversary of the initial equity public offering (May 10, 2008) of his or her LAZ-MD Holdings exchangeable interests, that person will not forfeit the right to early exchangeability with respect to the first tranche of his or her LAZ-MD Holdings exchangeable interests if he or she breaches the restrictive covenants (*i.e.*, non-compete and non-solicitation provisions) in the retention agreement of such individual (although shares in the second and third tranches that would otherwise become exchangeable would not be exchangeable until the eighth anniversary of our equity public offering (May 10, 2013) in such an instance).

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**Item 6. Exhibits**

- 2.1 Master Separation Agreement, dated as of May 10, 2005, by and among the Registrant, Lazard Group LLC, LAZ-MD Holdings LLC and LFCM Holdings LLC (incorporated by reference to Exhibit 2.1 to the Registrant's Quarterly Report (File No. 001-32492) on Form 10-Q filed on June 16, 2005).
- 2.2 Amendment No. 1, dated as of November 6, 2006, to the Master Separation Agreement, dated as of May 10, 2005, by and among the Registrant, Lazard Group LLC and LAZ-MD Holdings LLC.
- 2.3 Class B-1 and Class C Members Transaction Agreement (incorporated by reference to Exhibit 2.2 to the Registrant's Registration Statement (File No. 333-121407) on Form S-1 filed on December 17, 2004).
- 3.1 Certificate of Incorporation and Memorandum of Association of the Registrant (incorporated by reference to Exhibit 3.1 to the Registrant's Registration Statement (File No. 333-121407) on Form S-1/A filed on March 21, 2005).
- 3.2 Certificate of Incorporation in Change of Name of the Registrant (incorporated by reference to Exhibit 3.2 to the Registrant's Registration Statement (File No. 333-121407) on Form S-1/A filed on March 21, 2005).
- 3.3 Amended and Restated Bye-laws of Lazard Ltd (incorporated by reference to Exhibit 3.3 to the Registrant's Quarterly Report (File No. 001-32492) on Form 10-Q filed on June 16, 2005).
- 4.1 Form of Specimen Certificate for Class A common stock (incorporated by reference to Exhibit 4.1 to the Registrant's Registration Statement (File No. 333-121407) on Form S-1/A filed on April 11, 2005).
- 4.2 Indenture, dated as of May 10, 2005, by and between Lazard Group LLC and The Bank of New York, as Trustee (incorporated by reference to Exhibit 4.1 to Lazard Group LLC's Registration Statement (File No. 333-126751) on Form S-4 filed on July 21, 2005).
- 4.3 Third Supplemental Indenture, dated as of December 19, 2005, by and among Lazard Group LLC, The Bank of New York, as trustee, and for purposes of consent, Lazard Group Finance LLC (incorporated by reference to Exhibit 4.02 to the Lazard Group LLC's Current Report on Form 8-K (Commission File No. 333-126751) filed on December 19, 2005).
- 4.4 Purchase Contract Agreement, dated as of May 10, 2005, by and between the Registrant and The Bank of New York, as Purchase Contract Agent (incorporated by reference to Exhibit 4.4 to the Registrant's Quarterly Report (File No. 001-32492) on Form 10-Q filed on June 16, 2005).
- 4.5 Pledge Agreement, dated as of May 10, 2005, by and among the Registrant, The Bank of New York, as Collateral Agent, Custodial Agent and Securities Intermediary and The Bank of New York, as Purchase Contract Agent (incorporated by reference to Exhibit 4.5 to the Registrant's Quarterly Report (File No. 001-32492) on Form 10-Q filed on June 16, 2005).
- 4.6 Pledge Agreement, dated as of May 10, 2005, by and among Lazard Group Finance LLC, The Bank of New York, as Collateral Agent, Custodial Agent and Securities Intermediary and The Bank of New York, as Trustee (incorporated by reference to Exhibit 4.6 to the Registrant's Quarterly Report (File No. 001-32492) on Form 10-Q filed on June 16, 2005).
- 4.7 Form of Normal Equity Security Units Certificate (included in Exhibit 4.4).
- 4.8 Form of Stripped Equity Security Units Certificate (included in Exhibit 4.4).
- 4.9 Form of Senior Note (included in Exhibit 4.3).
- 10.1 Amended and Restated Stockholders' Agreement, dated as of November 6, 2006, by and among LAZ-MD Holdings LLC, the Registrant and certain members of LAZ-MD Holdings LLC.
- 10.2 Operating Agreement of Lazard Group LLC, dated as of May 10, 2005 (incorporated by reference to Exhibit 10.2 to the Registrant's Quarterly Report (File No. 001-32492) on Form 10-Q filed on June 16, 2005).

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- 10.3 Amendment No. 1 to the Operating Agreement of Lazard Group LLC, dated as of December 19, 2005 (incorporated by reference to Exhibit 3.01 to the Lazard Group LLC's Current Report on Form 8-K (File No. 333-126751) filed on December 19, 2005).
- 10.4 Tax Receivable Agreement, dated as of May 10, 2005, by and among Ltd Sub A, Ltd Sub B and LFCM Holdings LLC (incorporated by reference to Exhibit 10.3 to the Registrant's Quarterly Report (File No. 001-32492) on Form 10-Q filed on June 16, 2005).
- 10.5 Employee Benefits Agreement, dated as of May 10, 2005, by and among the Registrant, Lazard Group LLC, LAZ-MD Holdings LLC and LFCM Holdings LLC (incorporated by reference to Exhibit 10.4 to the Registrant's Quarterly Report (File No. 001-32492) on Form 10-Q filed on June 16, 2005).
- 10.6 Insurance Matters Agreement, dated as of May 10, 2005, by and between Lazard Group LLC and LFCM Holdings LLC (incorporated by reference to Exhibit 10.5 to the Registrant's Quarterly Report (File No. 001-32492) on Form 10-Q filed on June 16, 2005).
- 10.7 License Agreement, dated as of May 10, 2005, by and among Lazard Strategic Coordination Company, LLC, Lazard Frères & Co. LLC, Lazard Frères S.A.S., Lazard & Co. Holdings Limited and LFCM Holdings LLC (incorporated by reference to Exhibit 10.6 to the Registrant's Quarterly Report (File No. 001-32492) on Form 10-Q filed on June 16, 2005).
- 10.8 Administrative Services Agreement, dated as of May 10, 2005, by and among LAZ-MD Holdings LLC, LFCM Holdings LLC and Lazard Group LLC (incorporated by reference to Exhibit 10.7 to the Registrant's Quarterly Report (File No. 001-32492) on Form 10-Q filed on June 16, 2005).
- 10.9 Business Alliance Agreement, dated as of May 10, 2005, by and between Lazard Group LLC and LFCM Holdings LLC (incorporated by reference to Exhibit 10.8 to the Registrant's Quarterly Report (File No. 001-32492) on Form 10-Q filed on June 16, 2005).
- 10.10 First Amended and Restated Limited Liability Company Agreement of Lazard Asset Management LLC, dated as of January 10, 2003 (incorporated by reference to Exhibit 10.10 to Lazard Ltd's Registration Statement (File No. 333-121407) on Form S-1/A filed on February 11, 2005).
- 10.11 Amended and Restated Operating Agreement of Lazard Strategic Coordination Company LLC, dated as of January 1, 2002 (incorporated by reference to Exhibit 10.16 to Lazard Ltd's Registration Statement (File No. 333-121407) on Form S-1/A filed on February 11, 2005).
- 10.12 Lease, dated as of January 27, 1994, by and between Rockefeller Center Properties and Lazard Frères & Co. LLC (incorporated by reference to Exhibit 10.19 to Lazard Ltd's Registration Statement (File No. 333-121407) on Form S-1/A filed on February 11, 2005).
- 10.13 Lease with an Option to Purchase, dated as of July 11, 1990, by and between Sicomibail and Finabail and SCI du 121 Boulevard Hausmann (English translation) (incorporated by reference to Exhibit 10.20 to Lazard Ltd's Registration Statement (File No. 333-121407) on Form S-1/A filed on February 11, 2005).
- 10.14 Occupational Lease, dated as of August 9, 2002, Burford (Stratton) Nominee 1 Limited, Burford (Stratton) Nominee 2 Limited, Burford (Stratton) Limited, Lazard & Co., Limited and Lazard LLC (incorporated by reference to Exhibit 10.21 to Lazard Ltd's Registration Statement (File No. 333-121407) on Form S-1/A filed on February 11, 2005).
- 10.15 2005 Equity Incentive Plan (incorporated by reference to Exhibit 10.21 to the Registrant's Registration Statement (File No. 333-121407) on Form S-1/A filed on May 2, 2005).
- 10.16 2005 Bonus Plan (incorporated by reference to Exhibit 10.23 to the Registrant's Registration Statement (File No. 333-121407) on Form S-1/A filed on March 21, 2005).

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10.17 Agreement Relating to Retention and Noncompetition and Other Covenants, dated as of May 4, 2005, by and among Lazard Ltd, Lazard Group LLC and Bruce Wasserstein (incorporated by reference to Exhibit 10.23 to the Registrant's Quarterly Report (File No. 001-32492) on Form 10-Q filed on June 16, 2005).

10.18 Agreement Relating to Reorganization of Lazard, dated as of May 10, 2005, by and among Lazard LLC and Bruce Wasserstein (incorporated by reference to Exhibit 10.24 to the Registrant's Quarterly Report (File No. 001-32492) on Form 10-Q filed on June 16, 2005).

10.19 Agreement Relating to Retention and Noncompetition and Other Covenants, dated as of May 4, 2005, by and among the Registrant, Lazard Group LLC and Steven J. Golub (incorporated by reference to Exhibit 10.25 to the Registrant's Quarterly Report (File No. 001-32492) on Form 10-Q filed on June 16, 2005).

10.20 Form of Agreement Relating to Retention and Noncompetition and Other Covenants, dated as of May 4, 2005, applicable to, and related Schedule I for, each of Michael J. Castellano, Scott D. Hoffman and Charles G. Ward III (incorporated by reference to Exhibit 10.26 to the Registrant's Quarterly Report (File No. 001-32492) on Form 10-Q filed on June 16, 2005).

10.21 Agreements Relating to Retention and Noncompetition and Other Covenants (incorporated by reference to Exhibit 10.27 to the Registrant's Registration Statement (File No. 333-121407) on Form S-1/A filed on April 11, 2005).

10.22 Amended and Restated Letter Agreement, effective as of January 1, 2004, between Vernon E. Jordan, Jr. and Lazard Frères & Co. LLC (incorporated by reference to Exhibit 10.28 to the Registrant's Quarterly Report (File No. 001-32492) on Form 10-Q filed on June 16, 2005).

10.23 Acknowledgement Letter, dated as of November 6, 2006 from Lazard Group LLC to certain managing directors of Lazard Group LLC modifying the terms of the retention agreements of persons party to the Amended and Restated Stockholders' Agreement, dated as of November 6, 2006.

10.24 Letter Agreement, dated as of March 15, 2005, from IXIS Corporate and Investment Bank to Lazard LLC and Lazard Ltd (incorporated by reference to Exhibit 10.27 to the Registrant's Registration Statement (File No. 333-121407) on Form S-1/A filed on March 21, 2005).

10.25 Registration Rights Agreement, dated as of May 10, 2005 by and among Lazard Group Finance LLC, the Registrant, Lazard Group LLC and IXIS Corporate and Investment Bank (incorporated by reference to Exhibit 10.30 to the Registrant's Quarterly Report (File No. 001-32492) on Form 10-Q filed on June 16, 2005).

10.26 Letter Agreement, dated as of May 10, 2005, with Bruce Wasserstein family trusts (incorporated by reference to Exhibit 10.31 to the Registrant's Quarterly Report (File No. 001-32492) on Form 10-Q filed on June 16, 2005).

10.27 Senior Revolving Credit Agreement, dated as of May 10, 2005, among Lazard Group LLC, the Banks from time to time parties thereto, Citibank, N.A., The Bank of New York, New York Branch, JP Morgan Chase Bank, N.A. and JP Morgan Chase Bank, N.A., as Administrative Agent (incorporated by reference to Exhibit 10.32 to the Registrant's Quarterly Report (File No. 001-32492) on Form 10-Q filed on June 16, 2005).

10.28 First Amendment, dated as of March 28, 2006, to the Senior Revolving Credit Agreement, dated as of May 10, 2005, among Lazard Group LLC, the Banks from time to time parties thereto, Citibank, N.A., The Bank of New York, New York Branch, JP Morgan Chase Bank, N.A. and JP Morgan Chase Bank, N.A., as Administrative Agent (incorporated by reference to Exhibit 10.34 to Registrant's Quarterly Report (File No. 001-32492) on Form 10-Q filed on May 11, 2006).

10.29 Second Amendment, dated as of May 17, 2006, to the Senior Revolving Credit Agreement, dated as of May 10, 2005, among Lazard Group LLC, the Banks from time to time parties thereto, Citibank, N.A., The Bank of New York, New York Branch, JP Morgan Chase Bank, N.A. and JP Morgan Chase Bank, N.A., as Administrative Agent (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 001-32492) filed on May 17, 2006).

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10.30	Description of Non-Executive Director Compensation (incorporated by reference to Exhibit 10.33 to the Registrant's Quarterly Report (File No. 001-32492) on Form 10-Q for the quarter ended June 30, 2005).
10.31	Form of Award Letter for Annual Grant of Deferred Stock Units to Non-Executive Directors (incorporated by reference to Exhibit 99.1 to the Registrant's Current Report on Form 8-K (File No. 001-32492) filed on September 8, 2005).
10.32	Form of Agreement evidencing a grant of Restricted Stock Units to Executive Officers under the Lazard Equity Incentive Plan (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 001-32492) filed on January 26, 2006).
10.33	Termination Agreement dated as of March 31, 2006, by and among Banca Intesa S.p.A., Lazard Group LLC, and Lazard & Co. S.r.l. (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 001-32492) filed on April 4, 2006).
10.34	Amended and Restated \$150 Million Subordinated Convertible Promissory Note due 2018, issued by Lazard Funding LLC to Banca Intesa S.p.A. (incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K (File No. 001-32492) filed on May 17, 2006).
10.35	Amended and Restated Guaranty of Lazard Group LLC to Banca Intesa S.p.A., dated as of May 15, 2006 (incorporated by reference to Exhibit 10.4 to the Registrant's Current Report on Form 8-K (File No. 001-32492) filed on May 17, 2006).
10.36	\$96 Million Senior Promissory Note due 2008, issued by Lazard Group LLC to Banca Intesa S.p.A. (incorporated by reference to Exhibit 10.5 to the Registrant's Current Report on Form 8-K (File No. 001-32492) filed on May 17, 2006).
10.37	\$50 Million Subordinated Promissory Note due 2008, issued by Lazard Group LLC to Banca Intesa S.p.A. (incorporated by reference to Exhibit 10.6 to the Registrant's Current Report on Form 8-K (File No. 001-32492) filed on May 17, 2006).
10.38	Certificate of Transfer and Assignment with Amendments, dated as of May 15, 2006, by and between Banca Intesa S.p.A. and Citibank, N.A., acknowledged and accepted for certain purposes by Lazard Group LLC (incorporated by reference to Exhibit 10.7 to the Registrant's Current Report on Form 8-K (File No. 001-32492) filed on May 17, 2006).
10.39	Directors' Fee Deferral Unit Plan (incorporated by reference to Exhibit 10.39 to Registrant's Quarterly Report (File No. 001-32492) on Form 10-Q filed on May 11, 2006).
12.1	Computation of Ratio of Earnings to Fixed Charges.
31.1	Rule 13a-14(a) Certification of Bruce Wasserstein.
31.2	Rule 13a-14(a) Certification of Michael J. Castellano.
32.1	Section 1350 Certification for Bruce Wasserstein.
32.2	Section 1350 Certification for Michael J. Castellano.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: November 7, 2006

LAZARD LTD

By: /s/ Bruce Wasserstein  
Name: Bruce Wasserstein

Title: Chairman and Chief Executive Officer

By: /s/ Michael J. Castellano  
Name: Michael J. Castellano

Title: Chief Financial Officer